Supreme Court, U.S.
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91-605

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

DANNY O CHERIF and KHALED SANCHOU,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

I. WHETHER A FORMER EMPLOYEE WHO ACQUIRES INFORMATION REGARDING SECURITIES ISSUERS THROUGH AN ILLEGAL TRESPASS OF THE FORMER EMPLOYER'S PREMISES IS SUBJECT TO THE CADY, ROBERTS DISCLOSE OR REFRAIN FROM TRADING RULE THUS MAKING STOCK TRADING ACTIONABLE INSIDER TRADING UNDER RULE 10(B)(5).

II. WHETHER THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT LACKED JURISDICTION TO CONTINUE THE INJUNCTION AS TO NOMINAL DEFENDANT WHERE IT HELD THAT THE TRIAL COURT LACKED SUBJECT MATTER JURISDICTION.

III. WHETHER THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT ERRED BY REFUSING TO MODIFY THE INJUNCTION TO PERMIT THE RELEASE OF FUNDS WHICH WERE NECESSARY FOR NOMINAL DEFENDANT TO RETAIN COUNSEL, INCLUDING FUNDS THAT ARE NOT ALLEGED TO BE ILLEGAL PROCEEDS.

IV. WHETHER THE INJUNCTION IS VOID FOR LACK OF PERSONAL JURISDICTION BECAUSE EXTRATERRITORIAL SERVICE OF PROCESS WAS NOT AUTHORIZED IN THE ABSENCE OF SUBJECT MATTER JURISDICTION.

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JURISDICTION

On June 7, 1991, the United States Court of Appeals for the Seventh Circuit denied a request for a rehearing after amending its April 29, 1991 opinion in Securities and Exchange Commission v. Danny O. Cherif, Defendant and Khaled Sanchou, Nominal Defendant, 933 F.2d 403 (7th Cir. 1991). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

REASONS FOR GRANTING THE WRIT

A Writ of Certiorari is sought on behalf of petitioner Cherif because United States Court of Appeals for the Seventh Circuit has rendered a decision that conflicts with this Court's decisions in Chiarella v. United States, 445 U.S. 222 (1980) and Dirks v. SEC, 463 U.S. 646 (1983); and has rendered an opinion that further conflicts with opinions of the United States Court of Appeals for the Second Circuit in United States v. Newman, 664 F. 2d 12 (2d Cir. 1981); the Third Circuit in Rothberg v.

Rosenblum, 771 F. 2d 818 (3d Cir. 1985) and the Ninth Circuit in SEC v. Clark, 915 F. 2d 439 (9th Cir. 1990).

A Writ of Certiorari is also sought on behalf of Petitioner Sanchou because the United States Court of Appeals for the Seventh Circuit has rendered a decision that conflicts with this Court's decision in United States v. Corrick , 298 U.S. 435 (1936) and Bender v. Williamsport Area School Dist., 475 U.S. 534 (1986) and the decisions of United States Court of Appeals for the Second Circuit in Engleman v. Cahn, 425 F.2d 954 (2nd Cir. 1969); the Fifth Circuit in Warren G. Kleban Engineering Co. v. Caldwell, 490 F.2d 800 (5th Cir. 1974); the Eighth Circuit in Rock Island Millwork Co. v., Hedges-Gough Lumber Co., 337 F.2d 24 (8th Cir. 1964) and the Eleventh Circuit in Latin American Property and Casualty Ins. Co. v. Hi-Lift Marina, 887 F.2d 1477 (11th Cir. 1989). On another issue, the United States Court of Appeals for the Seventh Circuit has rendered a decision which is in conflict with the Fifth Circuit in FSLIC v. Dixon, 835 F.2d

554 (5th Cir. 1987) and misinterprets Caplin and Drysdale v. United States, 109 S.Ct. 2646 (1989) and United States v. Monsanto, 109 S.Ct. 2657 (1989); and on still another issue, has rendered a decision in conflict with Hitchman Coal and Coke Co. v. Mitchell, 245 U.S. 229 (1917).

FEDERAL STATUTES INVOLVED

Securities Exchange Act of 1934, 15 U.S.C. §78j(b), states in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act of 1934, 15 U.S.C. §78n(e), states in relevant part:

> (e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

Rule 10b-5, 17 C.F.R. §240.10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any

person, in connection with the purchase or sale of any security.

Rule 14e-3, 17 C.F.R. §240.14e-3 states:

> If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from (1) the offering person, (2) the issuer of the securities sought or to be sought by such tender offer, or (3) any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.
>
> (b) A person other than a natural person shall not violate paragraph (a) of this section if such persons shows that:
>
> > (1) The individual(s) making the investment decision on behalf of such person to purchase or sell any security described in paragraph (a) or to cause any such security to be purchased or sold by or on behalf of

others did not know the material, nonpublic information; and

(2) Such person had implemented one or a combination of policies and procedures, reasonable under the circumstances, taking into consideration the nature of the person's business, to ensure that individual(s) making investment decision(s) would not violate paragraph (a), which policies and procedures may including, but are not limited to, (i) those which restrict any purchase, sale and causing any purchase and sale of any such security or (ii) those which prevent such individual(s) from knowing such information.

(c) Notwithstanding anything in paragraph (a) to the contrary, the following transactions shall not be violations of paragraph (a) of this section:

(1) Purchase(s) of any security described in paragraph (a) by a broker or by another agent on behalf of an offering person; or

(2) Sale(s) by any person of any security described in paragraph (a) to the offering person.

(d)(1) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, it shall be unlawful for any person described in paragraph (d)(2) of this section to communicate material, nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such

communication is likely to result in a violation of this section except that this paragraph shall not apply to a communication made in good faith,

(i) To the officers, director, partners or employees of the offering person, to its advisors or to other persons, involved in the planning financing, preparation or execution of such tender offer;

(ii) To the issuer whose securities are sought or to be sought by such tender offer, to its officers, directors, partner, employees or advisors or to other persons, involve in the planning, financing, preparation or execution of the activities of the issuer with respect to such tender offer; or

(iii) To any person pursuant to a requirement of any statute or rule or regulation promulgated thereunder.

(2) The persons referred to in paragraph (d)(1) of this section are:

(i) The offering person or its officers, directors, partners, employees or advisers;

(ii) The issuer of the securities sought or to be sought by such tender offer or its officers, directors, partners, employees or advisors;

(iii) Anyone acting on behalf of the persons in paragraph (d)(2)(i) ore the issuer or persons in paragraph (d)(2)(ii); and

(iv) Any person in possession of material information relating to a tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from any of the above.

STATEMENT OF THE CASE

The Securities and Exchange Commission (the "SEC") brought this action pursuant to Sections 21(d) and 21(e) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. §§78u(d) and 78u(e), seeking a preliminary injunction and other relief against Danny O. Cherif ("Cherif") and Khaled Sanchou ("Sanchou").

The gravamen of the SEC's claim is that Cherif purchased and sold stocks in various publicly traded companies while in possession of material non-public information obtained from the First National Bank of Chicago ("First National") in violation of Sections 10(b) and 14(e) of the Act, 15 U.S.C. §§78j(b) and 78n(e), and Rules 10b-5 and 14e-3 promulgated thereunder, 17 C.F.R. §§240.10b-5 and 240.14e-3.

Sanchou was named as a "nominal defendant". The Complaint does not charge Sanchou with a violation of the securities laws. The SEC alleges, rather, that Sanchou granted Cherif power of attorney over certain banking and

brokerage accounts used in furtherance of the scheme and that Cherif's control over Sanchou's accounts required the Court's exercise of jurisdiction over Sanchou in order to insure the availability of the final relief, in the form of disgorgement, sought by the SEC.

On May 21, 1989, the SEC obtained, ex parte, a Temporary Restraining Order against Cherif and Sanchou which, inter alia, froze all of both defendants' assets. On May 31, 1989, the District Court converted the Temporary Restraining Order against Sanchou to a Preliminary Injunction based upon default. On July 14, 1989, Sanchou and Cherif filed separate motions, denominated Motion to Amend the Preliminary Injunction and Motion to Amend the Temporary Restraining Order respectively, seeking the release of frozen assets needed to pay attorneys' fees. On July 21, 1989, Sanchou filed his Motion to Vacate or, in the Alternative, Modify Preliminary Injunction based, in part, on inter alia, lack of personal

jurisdiction and the SEC's failure to state or prove a claim against Sanchou under the securities laws.

On September 8, 1989, the District Court entered a Preliminary Injunction against Cherif. On September 27, 1989, the District Court denied Cherif's Motion to Amend Temporary Restraining Order and Sanchou's Motion to Vacate or, in the Alternative, Modify the Preliminary Injunction. On February 12, 1990 the District Court denied defendants' Motions to Reconsider the Orders of September 8 and September 27, 1989.

Defendants appealed to the United States Court of Appeals for the Seventh Circuit. In an opinion dated June 7, 1991, the court affirmed the preliminary injunction as to Cherif and remanded with instructions for further consideration of whether Sanchou properly can be enjoined and, if so, whether modification of the existing injunction to exclude non-proceeds is necessary.

1. Statement Of Facts Relevant To Issues Presented By Daniel O. Cherif

During part of the period of the scheme to defraud alleged by the SEC, Cherif was employed by Shearson Lehman Hutton ("Shearson") first as a trainee and then as a registered representative (A., Comp. ¶¶7 and 10).[1] Cherif maintained trading accounts, in his own name, at First Chicago Investment Services, Charles Schwab & Co. ("Schwab") and Shearson (A., Comp., ¶¶13 and 18). Although the rules of Shearson and the New York Stock Exchange require brokers to obtain approval before trading in accounts outside their employing firm, Cherif did not

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[1] References to the Appendix and Record on Appeal will be made in the following manner: references to the Appendix will be denominated by "A" followed by a description of the document contained in the Appendix and the portion of page of the document where the referenced portion appears; materials contained in the balance of the record will be designated by "R" followed by the document no. reflected on the docket sheet contained in the first volume of the Record on Appeal and the portion or page of the document where the referenced portion appears.

obtain approval to trade in non-Shearson accounts (R.Doc. No. 19, ¶15). Cherif was authorized to execute trades on accounts in Sanchou's name at First National, Quick & Reilly and Shearson (A., Comp., ¶13).

From October, 1979 until his position was eliminated pursuant to a reduction in force in January, 1988, Cherif was employed in First National's International Financial Institutions Department (A., Comp., ¶7). During his employment at First National, Cherif executed a letter acknowledging, inter alia, First National's policies concerning the use or disclosure of confidential information acquired in the course of employment at First National (R. Doc. No. 17, Ex. C & D). However, the policies applied solely during the period in which signatories were employed by First National and terminated with their employment.

On May 22, 1989, the SEC filed its Verified Complaint, Ex Parte Application for Temporary Restraining Order and related materials (A.,

Comp.). The Complaint alleged, inter alia, that from May, 1988 to May, 1989, Cherif obtained material nonpublic information concerning contemplated extraordinary corporate transactions, including takeovers and buyouts, from First National, via a misappropriation or breach of fiduciary duty, which he utilized in connection with a series of trades described in the Complaint (and by causing others to do so) thereby generating approximately $250,000 in profits. (A., Comp., ¶10).

The SEC's Complaint was based, in part, on statements purportedly made to the FBI by a cooperating witness (subsequently identified as William Bronec, hereinafter "Bronec") as reflected on an affidavit attached to the Complaint (A., Comp., Ex. A.). On May 21, 1989, Judge Aspen granted the SEC's Motion for Temporary Restraining Order and entered a Temporary Restraining Order (A., Temporary Restraining Order).

On May 31, 1989, Cherif filed his Answer, invoking his Fifth Amendment privilege as to all matters raised in the Complaint (A. Cherif Answer).

On June 9, 1989, the Court entered an Order, pursuant to stipulation, amending the Temporary Restraining Order to authorize Cherif to withdraw $20,000 from his frozen assets for payment of attorneys' fees (R. Doc. Nos. 34 and 36).

On June 14, 1989, Cherif appeared for a deposition. Cherif, however, declined to testify on the basis of his Fifth Amendment privilege (R. Doc. No. 73, Ex. 3). On November 3, 1989, Cherif filed his Response to the SEC's Request for an Accounting, invoking his Fifth Amendment privilege and declining to provide an accounting (R. Doc. No. 166).

On May 31, and July 14, 1989, the SEC filed separate Memoranda in Support of its Motion for Preliminary Injunction (R. Doc. Nos. 7 and 73). On July 14, 1989, the SEC also filed separate

Motions for an order drawing adverse inferences and for an order of preclusion based on, inter alia, Cherif's invocation of his Fifth Amendment privilege at his deposition (R. Doc. No. 76).

The evidence adduced by the SEC in support of its Motion for Preliminary Injunction included a transcript from Cherif's deposition, a transcript of a surreptiously recorded conversation between Cherif and Bronec and affidavits of First National employees and others. The evidence adduced by the SEC included the following:

During his employment at First National, Cherif was issued a machine-readable identification card ("key card") to be used to enter the Bank during non-banking hours (R. Doc. No. 15, at ¶¶3 and 4). First National's records did not reflect that the key card assigned to Cherif was returned after he left First National's employment (R. Doc. No. 5, at ¶15). Two separate memoranda requesting that Cherif be granted access to the Bank to work on projects

for the International Financial Institutions Department, purportedly signed by Mr. Van Reepingham, were delivered to First National's Security Department (R. Doc. No. 78, Exs. A and B). Based on the memoranda, the key card was kept active (R. Doc. No. 78, ¶3). Van Reepingham denied signing the memoranda or directing Cherif to do any work for First National after December 31, 1987 (R. Doc. No. 77, ¶¶3 and 4).

Computer generated records of First National reflected that the key card assigned to Cherif was used to enter the Bank 34 times between March 13, 1988 and May 8, 1989 (R. Doc. No. 15, Ex. A). Brokerage records relating to the Cherif and Sanchou accounts reflect that trades in the stocks of companies involved in transactions with First National were made on dates after the alleged entries (R. Doc. No. 10; R. Doc. No. 18).

Over objection, the SEC introduced a transcript of a surreptiously recorded

conversation with Bronec, wherein Cherif purportedly admitted having an active identification card (R. Doc. No. 73, Ex. 2). Neither Cherif nor Bronec, however, attested to the accuracy of the recording (or transcript) and defendant objected to the admission of the transcript on the basis of lack of foundation and hearsay (R. Doc. No. 16).

There was no evidence that the key card was in Cherif's sole custody and control throughout the period in question. Bronec, moreover, refused to answer whether he ever had possession of a key card or used a key card to gain access to First National based on his Fifth Amendment privilege (A., Doc. No. 109, Bronec Dep., p.11).

The SEC did not introduce physical evidence that Cherif entered First National during the period alleged in the Complaint. No eyewitness testified that they saw Cherif in First National or in any area where information was stored.

The First National Bank building is a 56-story office building occupied by a major money

center bank. During the relevant period, First National's Specialized Finance Department had approximately 160 transactions under consideration (A., Doc. No. 109, Fox Dep. p.22, Burk Dep., p. 35). Documents concerning the subject transactions were maintained in a number of locations on the 10th and 16th floors of the Bank. Materials were routinely kept under lock and key and efforts were made to limit unauthorized access to the materials (A., Doc. No. 109, Bridges Dep., p. 44 and Burk Dep., p. 45). Issuers, targets and the transactions themselves were identified by code names to conceal and prevent access to information (A., Doc. No. 109, Bridges Dep., p. 38, Burk Dep., p. 98 and Green Dep., p.80-81). Members of the Specialized Finance Department worked late into the night and on weekends when transactions were being considered (A., Doc. No. 109, Bridges Dep., pp. 48-49, Green Dep., p.74). First National employees testified that they never complained to security that any documents were

missing or had been disturbed (A., Doc. No. 109, Bridges Dep., p.65, Burk Dep., pp. 120-121 and Green Dep., p.67).

Affidavits of First National employees attested in conclusory fashion that the Bank possessed material nonpublic information concerning the transactions referenced in the Complaint prior to the purchase of securities in the subject issuers by the Cherif and Sanchou account and on the dates on which the key card assigned to Cherif was used to enter the Bank (R. Doc. Nos. 12, 79, 80 and 85). None of the affidavits, however, specified what information or documents deemed material or nonpublic was accessed or obtained by Cherif. First National employees also testified that they considered all documents and information received or generated in connection with the transactions, including documents which were publicly available, to be confidential (A., Doc. No. 109, Bridges Dep., pp. 72, 82-83, Burk Dep., p. 131). First National personnel also considered the

fact of a transaction and/or First National's involvement in a transaction to be material nonpublic information (R. Doc. Nos. 79, ¶20; Doc. No. 80, ¶9).

Cherif purchased shares of the following issuers through accounts maintained in his own name or in the name of Sanchou: Consolidated Bathurst, Coleman Industries, Inc., Payless Cashways, Inc. and CIGNA Insurance.

Trades in Sanchou's accounts involving the subject stocks yielded profits of approximately $150,000 (R. Doc. No. 7, p.11). Trades in the Cherif accounts yielded approximately $86,000 in profits on the Consolidated Bathurst, Coleman and Payless Cashways stocks (R. Doc. No. 7, p. 11). Cherif's account, however, sustained losses on trades in the CIGNA stock and on Thomas Industries (R. Doc. No. 7, p.11 and No. 106, p.9).

The transactions referenced in the SEC's Complaint were either not consummated or were not completed on the terms proposed to First

National. The Coleman LBO was not completed as proposed (A. Doc. No. 109, Fox Dep., p. 67). First National did not provide financing in connection with the Payless Cashways transaction (A., Doc. No. 109, Fox Dep., p.71). The CIGNA transaction was still pending and underwent a significant number of substantive structural changes (A. Doc. No. 109, Fox Dep., p.75). The terms of the Ccnsolidated Bathurst transaction may also have been modified (A. Doc. No. 109, Burk Dep., p. 72).

The Payless Cashways transaction was under consideration by First National from late April, 1988 through June 5, 1988 when First National informed the issuer that it was not interested in proceeding with the transaction (A., Doc. No. 109, Green Dep., p. 42). During that same period, there were numerous entries without trades of Payless Cashways (R. Doc. No. 15, Ex. A). Further, although the Bank decided not to participate in the Payless deal on June 3, 1988 (A., Doc. No. 109, Green Dep., pp. 41-42), a

total of 3,500 shares were purchased on June 6, June 7 and June 9, 1988 after a purported entry on June 5, 1988.

No evidence was offered as to the date of public announcements of the subject transactions. The Coleman LBO was the subject of market analysis and rumors and was the basis for broker recommendations almost two weeks before any public announcement (R. Doc. No. 106, Ex. A).

Subsequent to the filing of Cherif's Memorandum in Opposition to the SEC's Motion for Preliminary Injunction, the SEC filed a Plea Agreement signed by Bronec (R. Doc. No. 125-1). The Bronec Plea Agreement was neither appended to nor referred to in any prior submissions by the SEC.

On September 8, 1989, the Court entered an Order of Preclusion and an Order drawing Adverse Inferences (R. Doc. No. 116). Further, on September 8, 1989, the Court entered an Order granting the SEC's Motion for Preliminary

Injunction without an evidentiary hearing (A. Preliminary Injunction Order).

On September 27, 1989, the Court entered an Order denying Cherif's Motion to Amend the Temporary Restraining Order finding, inter alia, "Cherif has failed to demonstrate that he has a legitimate claim to any of the frozen assets--that any portion of the assets are free from the taint of the securities fraud alleged by the SEC" and that Cherif chose to disobey the Court's Order by refusing to provide an accounting. (A., September 27, 1987 Order). The Court disregarded the fact that Cherif had properly invoked his Fifth Amendment right in his answer to the Complaint (A. Answer).

2. Statement Of Facts Relevant To Issues Presented By Khaled Sanchou.

Sanchou is a citizen of Tunisia and resides in Tunis, Tunisia (A., Sanchou Aff., p.1 ¶2). Sanchou has never been a citizen or a resident of the United States (A., Sanchou Aff. ¶2).

Sanchou is employed in Tunis, Tunisia and does not maintain an office in the United States (A., Sanchou Aff. ¶3). Sanchou has never conducted any business in the Northern District of Illinois in person (A., Sanchou Aff., ¶3).

Sanchou and Cherif are related by marriage. On or about March 17, 1988, Cherif opened an account, on Sanchou's behalf, at the brokerage house of Quick & Reilly, Inc. ("Quick & Reilly Account")(A., Sanchou Aff., ¶4). Sanchou also maintained money market and investment accounts at First Chicago and First Chicago Investment Service, a discount broker-dealer and a subsidiary of First Chicago (A., Comp., ¶15)(the "First National Accounts"). Sanchou opened the First National Accounts prior to 1987 (A., Sanchou Aff., ¶4). Cherif was a signatory on and had power of attorney over Sanchou's First National and Quick & Reilly accounts (A., Sanchou Aff., ¶4).

The initial deposits into the Quick & Reilly and First National accounts were made

with Sanchou's funds (A., Sanchou Aff., ¶5). Sanchou has denied that he was Cherif's nominee and has asserted title to all funds contained in the Quick & Reilly and First National accounts (A., Sanchou Aff., ¶5).

Sanchou was named in the Complaint as a "nominal defendant". The Complaint does not allege that Sanchou violated the securities laws. The sole allegations as to Sanchou are that:

> Sanchou is Cherif's cousin. Sanchou resides in Tunisia. Sanchou granted Cherif Power of Attorney over his banking and brokerage accounts in this country. These accounts were used in furtherance of the scheme complained of herein. Cherif's control over Sanchou's accounts makes it necessary and appropriate, pursuant to Rule 19 of the Federal Rules of Civil Procedure, for this Court to obtain jurisdiction over Sanchou to enable it to grant the complete relief, in the form of disgorgement and an equitable distribution of these funds, sought by the plaintiff." (A., Comp., ¶8).

The Complaint sought a preliminary injunction "freezing" all of Sanchou's assets and requiring Sanchou to render an accounting (A., Comp. ¶¶13-15). The Complaint does not,

however, seek entry of a final order directing Sanchou to either disgorge profits or pay civil penalties under the Insider Trader Sanctions Act of 1984, 15 U.S.C. §78u(d)(2)(a).

On Sunday, May 21, 1989, pursuant to the SEC's ex parte application, Judge Aspen entered a Temporary Restraining Order which, inter alia, "froze" all of Sanchou's assets and directed the defendants to appear, at 10:00 a.m., on May 31, 1989, for a hearing on the SEC's Motion for a Preliminary Injunction (A., May 31, 1989, Temporary Restraining Order). Judge Aspen's Order also permitted the SEC to serve Sanchou in Tunisia by International Express Mail, at his home or business address, or by publication (A., Temporary Restraining Order, p.11).

On May 21, and May 22, 1989, Rudolph Gerlich and Robert Patterson, Branch Chiefs in the SEC's Division of Enforcement, delivered copies of the Complaint, Temporary Restraining Order and related documents to Cherif and advised Cherif that service was being made on

behalf of Sanchou (R. Doc. No. 13, ¶¶2-5; R. Doc. No. 16 ¶¶3-5).

On May 24, 1989, Jerry Isenberg of the SEC, attempted to serve Sanchou via telefax (R. Doc. No. 14, ¶¶5-6). Mr. Isenberg was unable to transmit the entire Complaint and did not transmit the Temporary Restraining Order (R. Doc. No. 14, ¶¶5-7).

On May 25, and May 26, 1989, Mr. Patterson mailed the Complaint and other documents, via Airborne Express Mail, to two business addresses in Tunis, Tunisia (R. Doc. No. 16, ¶¶5-9). The Patterson Affidavit did not state that the efforts to service Sanchou via mail were successful or that, if successful, service was effected prior to the May 31, 1989 Preliminary Injunction Hearing (R. Doc. No. 16). There is no evidence that the materials were received by Sanchou or that the stated addresses were correct.

The SEC also attempted to personally serve Sanchou in Tunis, Tunisia on May 31, 1989. (R.

Doc. No. 91, Ex. A). A Tunisian process server executed an Affidavit which stated that he spoke with Sanchou, at his residence at 12:15 p.m. (i.e. 5:15 a.m. Chicago time) on May 31, 1989. The Affidavit does not indicate that the process server, in fact, served Sanchou with any documents at that time. Rather, the Affidavit states that the process server subsequently met with Sanchou at his office, at an unspecified date and time, and served Sanchou with unspecified documents related to this action. The process server's Affidavit does not describe when (and which) documents were provided to Sanchou and does not attest that Sanchou was provided with a copy of the Temporary Restraining Order or any other document notifying Sanchou of the date and time of the Preliminary Injunction Hearing. The SEC did not file a Supplemental Affidavit to attest that Sanchou was, in fact, served with process and/or notice of the Preliminary Injunction Hearing prior to 10:00 a.m. on May 31, 1989.

The Preliminary Injunction Hearing was convened at 10:00 a.m. on May 31, 1989. Sanchou did not attend the hearing and was not represented by counsel. (A., May 31, 1989 Temporary Restraining Order). On May 31, 1989, the Court granted the SEC's Motion to Continue the Temporary Restraining Order as to Cherif until the SEC's Motion for Preliminary Injunction as to Cherif could be adjudicated (R. Doc. No. 28). The Court, however, declined to similarly continue the hearing on the SEC's Motion for Preliminary Injunction as to Sanchou, found Sanchou in default and entered a Preliminary Injunction against Sanchou. (A., May 31, 1989 Preliminary Injunction Order).

Sanchou filed his Appearance on July 7, 1989 (R. Doc. No. 67). On July 21, 1989, Sanchou filed his Motion to Vacate or, in the Alternative, Modify Preliminary Injunction on the grounds that, inter alia the Court lacked personal jurisdiction over him when the Preliminary Injunction was issued and Sanchou

was denied adequate notice of and an opportunity to defend against the Motion for Preliminary Injunction (R. Doc. No. 91). Sanchou also moved, in the alternative, that the Preliminary Injunction be modified to freeze only profits of insider trading which might be subject to disgorgement. (R. Doc. No. 91).

On July 14, 1989, Sanchou filed a Motion to Amend the Preliminary Injunction seeking release of moneys necessary to pay attorneys' fees (R. Doc. No. 72). On September 27, 1989, Sanchou filed an Affidavit in Support of his Motion to Amend the Preliminary Injunction which provided, in part:

> Sanchou "did not acquire, obtain or possess any material nonpublic information relating to the issuers and transactions described in the SEC's Complaint prior to the purchasing or selling of stocks in those issuers. [Sanchou] had no personal knowledge of any material nonpublic information relating to any of the transactions identified in the SEC's Complaint" (A., Sanchou Aff., ¶6).

On September 27, 1989, the Court entered an Order denying Sanchou's Motion to Vacate the

Preliminary Injunction "for the same reasons stated by the Court in its Order of September 27, 1989 denying Cherif's Motion to Amend Temporary Restraining Order and by the SEC in opposition to the Motion" (A., September 27, 1989 Order).

BASIS OF JURISDICTION BELOW

The District Court is alleged to have had subject matter jurisdiction over this action pursuant to 28 U.S.C. §1331(a), as it is an action brought by the plaintiff/appellee, the Securities and Exchange Commission, pursuant to 21(d) and §21(e) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. §§78u(e) and 78(a)), to enjoin acts, practices and courses of business alleged to be in violation of §10(b) and §14(e) of the Exchange Act, 15 U.S.C. §§78j(b) and 78n(e), and Rules 10b-5 and 14e-3 (17 C.F.R. §§240.10b-5 and 240.14e-3) promulgated thereunder. The District Court was also alleged to have had personal jurisdiction over nominal defendant/appellant, Khaled

Sanchou, under Rule 19 of the Federal Rules of Civil Procedure. Both subject matter and personal jurisdiction were contested below by nominal defendant/appellant Sanchou.

The Seventh Circuit had jurisdiction over nominal defendant/appellant Sanchou's appeal pursuant to 28 U.S.C. §1292(a), as it is an appeal from an Order entered on September 27, 1989 by the District Court refusing to modify or dissolve an injunction pursuant to nominal defendant/appellant Sanchou's Motion to Vacate, or in the Alternative, Modify a Preliminary Injunction and Sanchou's Motion to Amend Preliminary Injunction. Nominal defendant/appellant's Motion to Reconsider the Order of September 27, 1989 was filed on October 6, 1989 thereby tolling the period within which nominal defendant/appellant was required to file his Notice of Appeal from the Order entered on September 27, 1989. The Order denying nominal defendant/appellant's Motions to Reconsider was entered on February 12, 1990. Nominal

defendant/appellant's Notice of Appeal was timely filed on April 6, 1990, within the sixty day period for filing a Notice of Appeal in an action involving a Federal Agency specified in Rule 4(a)(1) of Federal Rules of Appellate Procedure.

The Seventh Circuit had jurisdiction over defendant/appellant Danny O. Cherif's appeal pursuant to 28 U.S.C. §1292(a), as it is an appeal from Orders entered on September 8, 1989 and September 27, 1989 granting an injunction pursuant to plaintiff/appellee's MOtion For A Preliminary Injunction and refusing to modify or dissolve an injunction pursuant to defendant/appellant's Motion to Amend the Temporary Restraining Order, respectively. Defendant/ appellant's Motion to Reconsider the Order of September 27, 1989 denying defendant/appellant's Motion to Amend the Temporary Restraining Order was filed on October 6, 1989. Defendant/ Appellant's Motion to Reconsider the Order of September 8, 1989

granting plaintiff/appellee's Motion For a Preliminary Injunction was filed on September 19, 1989. The foregoing Motions to Reconsider tolled the time within which defendant/appellant was required to file a Notice of Appeal from Orders entered on September 8, and September 27, 1989, respectively. The Order denying both of defendant/appellant's Motions to Reconsider was entered on February 12, 1990. Defendant/appellant's Notice of Appeal was timely filed on April 9, 1990 and within the sixty (60) day period for filing a Notice of Appeal from an Order entered in an action involving a Federal agency as specified in Rule 4(a)(1) of the Federal Rules of Appellate Procedure.

ARGUMENT

I. THE SEVENTH CIRCUIT ERRONEOUSLY ADOPTED AN EXPANDED MISAPPROPRIATION THEORY OF INSIDER TRADING IN VIOLATION OF RULE 10(B)-5 BASED MERELY UPON POSSESSION OF MATERIAL, NONPUBLIC INFORMATION.

In an unprecedented decision, the United States Court of Appeals for the Seventh Circuit adopted an expanded version of the misappropriation theory of insider trading and imposed civil liability under the Federal Securities laws based on the rationale that mere possession of material nonpublic information creates a duty to abstain from trading based on this information. In doing so, the Seventh Circuit has adopted the parity of information theory in concluding that a possessor of information must abstain from trading regardless of how he acquired the information. In this case the information was acquired, not by the entrustment of confidential information in a special fiduciary relationship, but rather by trespass. The Seventh Circuit decision

conflicts with this Court's decisions in Dirks v. SEC, 463 U.S. 646 (1982) and Chiarella v. United States, 445 U.S. 222 (1980).

This Court has twice explicitly rejected the "parity of information theory" and held that the mere possession of material nonpublic information does not create a duty to abstain from trading. Dirks v. SEC, 463 U.S. 646, 654 (1982); and Chiarella v. United States, 445 U.S. 222, 233 (1980). The Court recognized that access to information, whether verified or unverified, accurate or inaccurate, and the assessment of this information by traders and analysts makes a market viable. Parity of information in a securities market is unattainable and probably counterproductive to a properly functioning securities market. Therefore, the Court concluded that the law only regulates the use of information, from any source, where there is a duty to disclose or abstain from trading. Dirks, 463 U.S. at 646; and Chiarella, 445 U.S. at 232. The Court

concluded that such a duty to abstain or disclose arises where fraud was perpetrated by a fiduciary violating his duty to his shareholders, the so called Cady, Roberts obligation. (In re Cady, Roberts & Co., 40 SEC 907 (1961)). The Court also recognized that outsiders, (underwriters, accountants, attorneys and consultants) who enter into special confidential relationships with corporations become fiduciaries of the shareholders of such companies, Dirks, 463 U.S. at 646, and also assume the Cady, Roberts obligation.

As the Court stated in a footnote in Dirks:

> Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.

Dirks, 463 U.S. at 655 n. 14.

The Cady, Roberts obligation arises from the premise that the information has been entrusted based upon an implied promise not to use the information for personal gain. If the information is utilized in stock trading, the implied promise becomes a misrepresentation which constitutes fraud in connection with the trading.

Chiarella held that a duty to disclose material information does not arise merely from possession of non-public market information alone. Chiarella, 445 U.S. at 235. See also United States v. Carpenter, 791 F. 2d 1024, 1031 (2d Cir. 1986). The Court explicitly rejected the equal access to information theory. Chiarella, 445 U.S. at 231-232. Rather, the Court held that securities fraud requires a breach of an independent duty to disclose information. Specifically, the Court stated:

> But one who fails to disclose material information prior to the consummation of a transaction commits fraud only

> when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to know because of the fiduciary or similar relation of trust and confidence between them."

Id. at 228.

The Chiarella Court further stated: "Accordingly, a purchaser of stock who has no duty to a prospective seller because he is neither an insider nor a fiduciary, has been held to have no obligation to reveal material facts. See General Tire Corp. v. Talley Industries, Inc., 403 F.2d 159, 164 (2nd Cir. 1968), cert. denied, 393 U.S. 1026 (1969)." Id. at 229.

Dirks also held that one who acquires non-public information is not under a duty to abstain from trading absent a duty to disclose. In Dirks, the Court held that a duty to abstain from trading arises from the relationship between the parties and not merely from one's ability to acquire the information. The Dirk's

Court reiterated its holding in Chiarella stating:

> We were explicit in Chiarella in saying that there can be no duty to disclose where a person who has traded on inside information "was not [the corporation's] agent, ... was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U.S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forego actions based on material nonpublic information.

Id., at 654.[2] (citation omitted).

Under Chiarella and Dirks, to establish a violation of §10(b) or Rule 10(b)(5), there must

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[2] In Dirks, the Supreme Court held that persons who obtain inside information are free to trade on such information absent a violation of a fiduciary duty by their insider-tipper of which the tippee knew or should have known. Specifically, the Court held that: "...there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain." Dirks, 463 U.S. at 664.

be fraud based on a violation of the Cady, Roberts obligation which was in turn, based upon the existence of a special relationship between the parties.

The Seventh Circuit, rejecting this Court's decisions in Chiarella and Dirks, instead, followed a line of cases from the Second Circuit represented by United States v. Newman, 664 F. 2d 12 (2d Cir. 1981), cert. denied, 464 U.S. 863 (1983), styled the misappropriation theory. This theory extends the Cady, Roberts obligation of insiders or tippees of insiders to anyone who is entrusted with material nonpublic information while occupying a fiduciary relationship with a lawful possessor of the information.

The misappropriation theory, as articulated by the Seventh Circuit disregards the Cady, Roberts obligation of an insider or fiduciary to the shareholders as the basis of the insider trading liability under Rule 10(b)(5). However, it is the fraud, not the access to information, that is proscribed by Rule 10(b)(5) and it is

not the breach of a fiduciary duty generally, but the fraudulent failure to disclose where that obligation exists that is proscribed. Absent a duty to disclose, there is no fraud on the stock sellers.

The Seventh Circuit, in adopting the "misappropriation theory" of expanded liability to outsiders, ignored the analysis set forth in the applicable precedent established by the Court in Dirks and Chiarella. To support its decision the Seventh Circuit uncritically adopted the Second Circuit cases, including United States v. Newman, 664 F.2d 12 (2d Cir. 1981). This Court has declined to adopt the rationale of Newman and Carpenter previously and should not do so now. Particularly, the Court should not extend a theory and thereby distort the Federal Securities statutes in order to fashion an unnecessary sanction. The alleged conduct may be actionable under other civil and criminal statutes and prosecution under the

Federal Securities statutes is completely unnecessary.

The Cady, Roberts obligation arises from the inherent unfairness of entrusting a fiduciary with corporate information which the fiduciary then misuses for personal benefit. Under the expanded misappropriation theory, an obligation to disclose to everyone is created so as to avoid a personal benefit from dealing with independent third parties who are willing to sell their stock in an open market and not to prevent a personal gain from a fiduciary dealing with his beneficiaries. The problem is that the profits, if any, derived from trading with third parties in an open market are not the direct result of the breach of fiduciary duty. If any advantage accrues to the trader, it is because of unequal information in the marketplace, not because the fiduciary has taken advantage of his beneficiary. The same rationale that supports the Court's rejection of a parity of information

requirement in Dirks and Chiarella supports the rejection of this expansion of securities fraud.

If a theory of liability as present in Newman, et al., is adopted, it should be recognized that it is based upon an entrustment rationale, i.e., that the obtaining of information was by way of an entrustment within a fiduciary relationship and that such an entrustment should not result in misuse of that information for the benefit of the fiduciary with injury to the entruster. Indeed this approach is recognized in Dirks at footnote 14, 463 U.S. at 655, to the effect that any liability flows from the wrongdoer having entered into a special confidential relationship where he is given access to information solely for corporate purposes. Thus liability would stem from a misused entrustment, not a misappropriation.

In any event, even if a Newman type theory is adopted, entrustment of material non public information within a fiduciary relationship

should be essential. Under the misappropriation theory adopted by the Seventh Circuit, §10b and Rule 10b-5 are violated by the conversion or misappropriation of material non-public information in connection with the purchase or sale of securities. This application entirely omits any requirement that the acquisition and use of information constitutes a fraud and, will radically alter the law governing insider trading. Every case which has upheld a claim under the misappropriation theory, including each of the cases cited by the Seventh Circuit was based on a finding that the defendant's acquisition and use of inside information breached a fiduciary duty stemming from an entrustment of the information. No cases have been found which have upheld a claim under the misappropriation theory in the absence of an entrustment and a breach of a fiduciary duty.[3]

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[3] United States v. Newman, 664 F. 2d 12 (2d Cir. 1981) (employee of investment banking firm breached fiduciary duty to employer and employer's clients); SEC v.

This Court has recognized that while 10b-5 is a catchall antifraud provision, it must catch fraud, not trespass or burglary. See Chiarella, 445 U.S. at 226, citing Ernst and Ernst v. Hochfelder, 425 U.S. at 185, 197 (1976). In this case there is no entrustment nor any breach of fiduciary duty, hence no fraud.

Even if a Newman type theory is appropriate, the Seventh Circuit decision

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Materia, 745 F. 2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985)(employee of printing firm breached fiduciary duty owed to employer); United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1987), aff'd, 484 U.S. 19 108 S. Ct. 316 (1987)(employee breached fiduciary duty to publisher employer); S.E.C. v. Clark, 915 F. 2d 439 (9th Cir. 1990); SEC v. Tome, 638 F.Supp. 596 (S.D.N.Y. 1986), SEC v. Musella, 578 F. Supp. 425 (S.D.N.Y. 1984) aff'd, 833 F.2d 1086 (2d Cir. 1987); U.S. v. Willis, 737 F. Supp. 269 (S.D.N.Y. 1990); United States v. Elliott, 711 F. Supp. 425 (N.D. Ill. 1989) (attorney breach of fiduciary duty); SEC v. Peters, 735 F. Supp. 1505 (D.C. Kan. 1990) (partner's breach of fiduciary duty to partnership); Rothberg v. Rosenblum, 771 F. 2d 818 (3d Cir. 1985) (director breach of fiduciary duty).

conflicts with the holdings of the Second Circuit in Newman, the Third Circuit in Clark and the Ninth Circuit in Rothberg in that each of those decisions involved material information entrusted to a fiduciary by virtue of a fiduciary relationship, such as employment. Contrary to the Seventh Circuit's opinion, Cherif violated no fiduciary duty in acquiring alleged material, non public information. The Complaint alleges unauthorized access on the bank's premises after termination of Cherif's employment. Access to information in the bank was by an illegal unauthorized trespass. It is uncontradicted that Cherif was not an employee at the time of any alleged access to material, non public information. It is also uncontested that there was no entrustment of any material non public information to Cherif.

The Seventh Circuit in a quantum leap to apply its new Newman misappropriation doctrine found that confidential information acquired by Cherif during his employment was later used to

aid a subsequent illegal entry into the bank to obtain the "inside information" i.e., material, nonpublic information traded upon. The information used as a means to later acquire inside information was not itself inside information necessary to be disclosed. Thus, the Seventh Circuit holds that 10(b)(5) liability flows from a mere breach of confidentiality when used as a means to later acquire material non public information. The Seventh Circuit held that a breach of a continuing duty of confidentiality would support a fiduciary obligation to buttress a Newman type violation of a fiduciary duty. This is very far removed from any Cady Roberts disclosure obligation.

Moreover, the information used as a means cited in the Seventh Circuit's opinion does not constitute "confidential information" sufficient to support a continuing fiduciary duty of confidentiality. The opinion identified four items which allegedly constitute confidential

property or information which a former employee allegedly owes a continuing duty not to utilize, including: (1) a key card; (2) the appearance of Cherif's superior's signature; (3) First Chicago's procedure concerning the activation of key cards; and, (4) the location of information regarding upcoming transactions. None of these items are "confidential information" or protectable property sufficient to support a continuing fiduciary duty. Nor are they material, nonpublic information which invokes a disclose or abstain from trading obligation. They are merely general knowledge which the former employee can use.

A former employee's common law duty of confidentiality is limited and applies solely to information in which the employer holds a protectable property interest, and such property is principally comprised of trade secrets. Cincinnati Tool Steel Co. v. Breed, 136 Ill.App.3d 267, 482 N.E. 2d 170 (2d Dist. 1985); Lincoln Towers Insurance Agency v. Farrell, 99

Ill. App. 3d 353, 425 N.E. 2d 1034 (1st Dist. 1981). The specific items cited by the Seventh Circuit are clearly not trade secrets nor protectable confidential property. Schulenburg v. Signatrol, Inc., 33 Ill. 2d 379, 212 N.E. 2d 865 (1965), cert. denied, 383 U.S. 959 (1966); ILG Industries, Inc. v. Scott, 49 Ill. 2d 88, 273 N.E. 2d 393 (1971). There has also been no showing that First Chicago had a protectable property interest in the information cited in the opinion.

The common law duty cited by the opinion does not apply to "general knowledge" acquired during the course of employment. Restatement (Second) of Agency §396 (1958). Courts have consistently held that "an employee may take with him, at the termination of his employment, general skills and knowledge acquired during his tenure with the former employer". Schulenburg, 33 Ill.2d at 387 212, N.E.2d at 869; MBL (U.S.A.) Corp. v. Diekman, 112 Ill. App. 3d 229, 445 N.E.2d 418 (1st Dist. 1983); and Abbott v.

Redmont Thinlite Corp., 475 F. 2d 85, 89 (2nd Cir. 1973) (an employee may properly use general information concerning the former employee's method of business).[4]

The appearance of Cherif's boss' signature is not confidential information subject to a protectable interest. Such data is not confidential or secret. Knowledge of the same is mere "general knowledge" and the fact that Cherif may have acquired such knowledge in the course of his employment does not preclude its use or support a finding of a continuing fiduciary duty. Bickley v. Frutchey, 173 F. Supp. 516, 521 (E.D. Mich. 1959); and Packard, 89 Ill.App.3d at 917, 412 N.E. 2d at 623-624.

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[4] Proof of precautions taken to safeguard information or labeling data in an agreement as confidential does not establish that the data is confidential. Packard Instrument Co. v. Reich, 89 Ill. App. 3d 908, 412 N.E.2d 617 (1st Dist. 1980); Sarkes Tarzian, Inc. v. Audio Devices, Inc., 166 F. Supp. 250 (S.D. Cal. 1958), aff'd, 283 F. 2d 695 (9th Cir. 1960); Victor Chemical Works v. Iliff, 299 Ill. 532, 132 N.E. 806 (1921).

Similarly, Cherif's alleged knowledge of the procedure by which First Chicago key cards were activated is general knowledge of an employer's method of business. There is no evidence that such a process was, in fact, secret or limited to employees with a "need to know." More importantly, there is no evidence that Cherif acquired knowledge of this procedure or the location of documents regarding the subject transactions while he was employed by First Chicago. Absent such evidence, there can be no finding that Cherif acquired such data while subject to a fiduciary duty.[5]

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[5] Cherif's use of the key card does not constitute a breach of a fiduciary duty. An employee's duty not to appropriate an employer's property is applicable only while the defendant was acting as an agent or employee. ABC Trans National Transport, Inc. v. Aeronautical Forwarders, Inc., 62 Ill. App. 3d 671, 379 N.E. 2d 1228 (1st Dist. 1978); and Prudential v. Van Matre, 158 Ill. App. 3d 298, 511 N.E. 2d 740 (5th Dist. 1987). Although a former employee may not appropriate his former employer's property after termination of employment, the prohibition is not grounded in agency law and does not constitute a breach of

At the time of the alleged entries, Cherif did not owe a fiduciary duty to abstain from utilizing either general knowledge of First National's procedures or its identification cards. More importantly, Cherif's alleged misuse of the identification card and his knowledge of procedures are not the use or disclosure of confidential information necessary to support a breach of a fiduciary duty by misusing material non public information required by the Securities Laws. Rather, under the Newman precedent, the issue is whether Cherif breached a fiduciary duty to abstain by trading on the basis of material nonpublic information which he acquired during the course of his employment or in violation of a fiduciary duty. The evidence demonstrated that Cherif did not obtain the alleged material non public information from First Chicago during his

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fiduciary duty. For this reason, though such conduct may be actionable in tort, it is not violative of the Federal Securities Laws.

employment and, therefore, his alleged trading did not breach a fiduciary duty to abstain from trading nor was it acquired in an entrustment within a fiduciary relationship.

II. THE SEVENTH CIRCUIT NOMINAL DEFENDANT LACKED JURISDICTION TO CONTINUE THE INJUNCTION AS TO WHERE THE SEVENTH CIRCUIT HELD THAT THE TRIAL COURT LACKED SUBJECT MATTER JURISDICTION

The Seventh Circuit properly determined that the District Court lacked subject matter jurisdiction over Sanchou and that "[none] of the SEC's arguments can support an exercise of jurisdiction over Sanchou to justify divesting him of the funds now in his accounts" (Slip. Op. P. 17-18). The injunction entered below, therefore, is void and a nullity CFTC v. Nahas, 738 F.2d 487 (D.C. Cir. 1984). Under this Court's precedent, the Seventh Circuit's jurisdiction was limited to vacating the injunction an/d remanding the action with directions to dismiss the SEC's "claim" against Sanchou. United States v. Corrick, 298 U.S.

435, 440 (1936); Bender v. Williamsport Area School Dist., 475 U.S. 534, 541 (1986). As the Court stated in Valley v. Northern Fire & Marine Ins. Co., 254 U.S. 348:

> Courts are constituted by authority and they can not go beyond the power delegated to them. If they act beyond that authority, and certainly in contravention of it, their judgments and orders are regarded as nullities. They are not voidable, but simply void.

Id. at 353-54: See also, Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702 (1982).

The Seventh Circuit, however, not only failed to vacate the injunction, it retained jurisdiction over Sanchou, continued the void injunction, remanded the case for an evidentiary hearing and rendered an extensive advisory opinion which suggested alternative means by which the SEC might attempt to cure the lack of subject matter jurisdiction. In so doing, the Seventh Circuit exceeded its jurisdiction and

deviated radically from its established precedent. Foster v. Center Township of LaPorte, 798 F.2d 237, 241 (7th Cir. 1986); Love Church v. City of Evanston, 896 F.2d 1082, 1084 (7th Cir. 1990), cert. denied, 111 S.Ct. 252 (1990).

Other Circuit Courts have uniformly held that once an Appellate Court determines that the Trial Court lacked jurisdiction and the order appealed from is void, the function of the Court of Appeals is limited to vacating the order and remanding with directions to dismiss the claim for lack of jurisdiction. Warren G. Kleban Engineering Co. v. Caldwell, 490 F.2d 800, 803 (5th Cir. 1974), Engleman v. Cahn, 425 F.2d 954, 958-959 (2d Cir. 1969), cert. denied, 387 U.S. 1009 (1970); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969); Rock Island Millwork v. Hedges - Gough Lumber Co., 337 F.2d 24, 27-28 (8th Cir. 1964); and Latin American Property and Casualty v. Hi-Lift Marina, 887 F.2d 1477, 1479 (11th Cir. 1989)(the Appellate Court is "duty bound"

to dismiss any case in which the subject matter jurisdiction is lacking).

In contravention of these authorities, the Seventh Circuit failed to vacate and, indeed, continued the injunction as to Sanchou despite its decision that the District Court lacked subject matter jurisdiction to issue an injunction. The injunction below was void and a nullity. CFTC v. Nahas, 738 F.2d 487 (D.C. Cir. 1984). The Seventh Circuit also lacked jurisdiction to enter or maintain an injunction as to Sanchou. Air Transport Association of America v. Professional Air Traffic Controllers Organization, 516 F.Supp. 1108, 1110 (S.D.N.Y. 1981), aff'd, 667 F.2d 316 (2d. Cir. 1981). Nevertheless, the Seventh Circuit refused to vacate and, indeed, continued the effect of the void injunction. In so doing, the Seventh Circuit did not state the basis for its decision or cite any authority for its action. Sanchou contends that no authority exists. Sanchou, moreover, is placed in the anomalous position of

having all of his assets frozen despite any allegation, evidence or finding of wrongdoing by him and a determination by the Court that the injunction was void for want of subject matter jurisdiction.[6]

III. THE SEVENTH CIRCUIT ERRED BY REFUSING TO MODIFY THE INJUNCTION TO PERMIT THE RELEASE

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[6] The Seventh Circuit compounded its error by remanding the action with directions the Trial Court to hold an evidentiary hearing "to determine the proper capacity in which Sanchou should be sued" (Slip. Op., at P.22). As this Court and even the Seventh Circuit Court have consistently held, subject matter jurisdiction is determined at the time the action is filed and solely by reference to the face of the complaint, Nuclear Engineering Co. v. Scott, 660 F.2d 241, 248-249 (7th Cir. 1981), cert. denied, 455 U.S. 993 (1982); Arkansas v. Kansas & Texas Coal Co., 183 U.S. 185, 188 (1901). The relevant inquiry, therefore, is what basis for subject matter jurisdiction was alleged in the SEC's Complaint. The SEC's Complaint alleges and the Trial Court found that jurisdiction over Sanchou existed under Rule 19 of the Federal Rules of Civil Procedure (A. Comp. P.3, ¶8; R. Item 30, at 1). As noted by the Seventh Circuit, "Rule 19 is not a source of Federal jurisdiction" (Slip Op. P.17). On its face, therefore, the SEC's Complaint fails to state a proper basis for subject matter jurisdiction over Sanchou.

OF FUNDS NECESSARY FOR NOMINAL DEFENDANT TO RETAIN COUNSEL, INCLUDING FUNDS THAT ARE NOT ALLEGED TO BE PROCEEDS OF ANY ALLEGED ILLEGALITY

Sanchou contends that the Seventh Circuit's opinion erred in failing to find an abuse of discretion in that the District Court's Order violated Sanchou's Fifth Amendment right to retain private counsel, misinterpreted FSLIC v. Dixon, 835 F.2d 554 (5th Cir. 1987), and erroneously relied upon Caplin & Drysdale, Charter v. United States, 109 S.Ct. 2646 (1989) and United States v. Monsanto, 109 S.Ct. 2657 (1989). The Seventh Circuit's opinion conflicts with the Fifth Circuit's decision in Dixon and misapplies Drysdale and Monsanto.

The District Court erroneously held that Sanchou bore the burden of proving that he had a "legitimate claim" to a portion of the frozen assets as a prerequisite to the release of frozen assets necessary to pay attorneys' fees, citing FSLIC v. Dixon, 835 F.2d 554 (5th Cir. 1987). The record demonstrates that the

District Court, however, misinterpreted the Dixon decision and applied an erroneous legal standard.

In Dixon, the 5th Circuit held that:

> "... some kind of allowance should be made to permit each defendant to pay reasonable attorneys' fees if he is able to show that he cannot pay them from new or exempt assets; the burden, however, will be on the defendant to satisfy the Court that he can secure the services of an attorney only if assets subject to the Freeze Order are released" Id., at 565. (Emphasis Added).

Under Dixon, Sanchou was required to demonstrate that he is unable to pay attorneys' fees from assets other than those subject to a freeze order and, if he can do so, Sanchou should be permitted to utilize alleged "proceeds" in order to fund his defense. Dixon, 835 F.2d at 565-566. Dixon did not, as a District Court held, require Sanchou to prove that he had a "legitimate claim" to frozen assets (i.e., the assets were not the proceeds of the alleged fraud) in order to obtain the release of funds necessary to defend himself. The portion of the Dixon opinion cited by the

District Court does not relate to the burden imposed on a defendant to secure the release of frozen assets necessary to pay attorneys' fees. Rather, under the portion of Dixon relied upon below, a defendant is required to demonstrate a legitimate claim to frozen assets in order to obtain an exemption from the Freeze Order for assets that were not obtained by fraud, and therefore, not subject to an equitable remedy of restitution or recision.[7]

In the instant case, all of Sanchou's assets have been frozen and, therefore, he is not able to pay attorneys' fees from nonfrozen assets. Under Dixon, Sanchou must be permitted to use alleged "proceeds" in order to fund his defense. The Seventh Circuit's decision,

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[7] As recognized by the 9th Circuit in FTC v. World Wide Factors, Ltd., 882 F.2d 344 (9th Cir. 1989), Dixon retains its viability despite the subsequent decisions in Drysdale and Monsanto. The Ninth Circuit cited Dixon with approval despite its prior reference to Drysdale and Monsanto. World Wide Factors, 882 F.2d at 348.

therefore, conflicts with Dixon. Further, as the SEC has conceded, there is approximately $100,000 in Sanchou's account which are not even alleged to be "proceeds". As to the "nonproceeds", Sanchou has demonstrated a "legitimate claim" to those frozen assets. Nonproceeds should be made available to Sanchou for any purpose which he deems appropriate, including payment of attorneys' fees.

The Seventh Circuit misapplied the Supreme Court's decisions in Monsanto and Drysdale in affirming the Trial Court's refusal to modify the injunction to permit Sanchou to use "nonproceeds" to retain an attorney. The assets subject to seizure in Monsanto and Drysdale were expressly limited by 21 U.S.C. §853(e) to property derived from or constituting "proceeds" from criminal activity. The preliminary injunction, however, froze all of Sanchou's assets, including funds which the SEC concedes are not "proceeds" of alleged illegal activity. The Seventh Circuit, ignored this important

limitation on Monsanto and Drysdale and extended their reach to "nonproceeds".

Additionally, both Drysdale and Monsanto were based on the premise that the defendant would not be deprived of all representation in view of the right to appointed counsel in a criminal proceeding. Sanchou is not the subject of a criminal complaint and, therefore, is ineligible for appointed counsel, Wolfolk v. Rivera, 729 F.2d 1114, 1119-1120 (7th Cir. 1984). Therefore, Sanchou's Fifth Amendment right to retain counsel (and, indeed, his very ability to defend himself through counsel), was abridged by the Trial Court's Freeze Order.[8] Neither Drysdale nor Monsanto addressed the issue presented by Sanchou and the Seventh

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[8] The right to retain counsel in a civil case is implicit in the concept of due process. Potashnick v. Port City Construction Co., 609 F.2d 1101, 1117 (5th Cir. 1980); FTC v. Atlantex Association et al., Trade Reg. Rptr. (CCH) ¶68,585 (11th Cir. 1989); and Powell v. Alabama, 287 U.S. 45, 69 (1932).

Circuit's reliance on those decisions was misplaced.

IV. THE PRELIMINARY INJUNCTION ISSUED AGAINST SANCHOU IS VOID FOR LACK OF PERSONAL JURISDICTION BECAUSE EXTRATERRITORIAL SERVICE OF PROCESS ON SANCHOU IN TUNISIA WAS NOT AUTHORIZED UNDER RULE 4 OF THE FEDERAL RULES OF CIVIL PROCEDURE

The Seventh Circuit properly held that, as to Sanchou, the District Court lacked subject matter jurisdiction under the Securities Exchange Act of 1934 (the "Act")(Slip. Op. pp.17-18). That determination also mandated a finding that the extraterritorial service of process of Sanchou in Tunisia was invalid and, therefore, the District Court lacked personal jurisdiction over Sanchou.

The Temporary Restraining Order permitted the SEC to serve Sanchou in Tunisia and Sanchou was allegedly personally served in Tunis, Tunisia (A., Temporary Restraining Order, p. 11; R. Doc. No. 91, Ex. 1). Pursuant to Rule 4, a party may only be served with process in a

foreign country where a Federal statute (or a Court Order thereunder) "authorizes service upon a party not an inhabitant of or found within the state in which the District Court is held" F.R.C.P. 4(i)(1). In the instant case, the Federal statute which purportedly authorized extraterritorial service of process was §27 of the Act, 15 U.S.C. §78aa.

The Seventh Circuit held the District Court lacked subject matter jurisdiction under the Act. (Slip. Op. pp. 17-18). Absent subject matter jurisdiction under the Act, extraterritorial service of process was not authorized by Rule 4 and, therefore, the service was invalid. Because service was invalid, the District Court lacked personal jurisdiction over Sanchou. The Preliminary Injunction, therefore, was void. Hitchman Coal & Coke Co. v. Mitchell, 245 U.S. 229 (1917).

Sanchou did not waive his argument that the injunction is void for lack of personal jurisdiction and the Seventh Circuit's

conclusion that such a waiver occurred is based on a misapprehension of the facts and governing law. A party may waive a defense of lack of personal jurisdiction only by failing to assert it either in a Motion under Rule 12 or his first responsive pleading. F.R.C.P. 12(h)(i). Sanchou's Motion to Dismiss under Rule 12(h)(1) and (6), filed on July 21, 1989, raised the issue of the Court's lack of jurisdiction.

The Seventh Circuit misapprehended the record and the governing law by holding that Sanchou's first "responsive pleading" was a Motion to Amend the Preliminary Injunction filed on July 17, 1989. The Motion, however, did not asset an objection to the Complaint or a defense to the action under Rule 12(b). The waiver provisions of Rule 12(h) are limited to objections to the Complaint and/or defenses to the action which must be raised under Rule 12(b). Greenwald v. Cunard Steam-Ship Co., 162 F.Supp. 250, 251 (S.D.N.U. 1958); Charles Labs, Inc. v. Banner, 79 F.R.D. 55, 58 (S.D.N.Y.

1978); Wheeler v. Lientz, 25 F.Supp. 939 (W.D.Mo. 1939); See also: 2 Moore's Federal Practice, 2329, §12.23 (2d Ed., cert. denied, 107 s.Ct. 1303 (1987). Because Sanchou's Motion did not assert a defense to the action or an objection to the Complaint under Rule 12(b), it was not subject to the waiver provisions of Rule 12(h). Moreover, Sanchou did timely raise the defense of lack of jurisdiction by asserting the absence of jurisdiction in his Motion to Dismiss under Rule 12(b)(1) and (6). The sole authority cited by the Seventh Circuit in Giotis v. Appollo of Ozarks, Inc., 800 F.2d 660 (7th Cir. 1986), is clearly distinguishable because that defendant filed an answer which omitted the defense of personal jurisdiction, Id, at 663. Sanchou, conversely, included the defense of lack of jurisdiction in his Motion to Dismiss.

WHEREFORE, for the above and foregoing reasons Petitioners respectfully pray that a Writ of Certiorari be granted.

Respectfully submitted,

By _____
One of the attorneys for
Petitioners Danny O. Cherif
Defendant and Khaled Sanchou
Nominal Defendant

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APPENDIX

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IN THE
UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

June 7, 1991

Before

Hon. WALTER J. CUMMINGS, Circuit Judge
Hon. JOHN L. COFFEY, Circuit Judge
Hon. DANIEL A. MANION, Circuit Judge

Nos. 90-1688
90-1805

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

DANNY O. CHERIF,

Defendant-Appellant,

and

KHALED SANCHOU,

Nominal Defendant-Appellant.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 89 C 4204—**Charles R. Norgle,** *Judge.*

ORDER

On consideration of the three petitions for rehearing, the following modifications are being made in the April 29, 1991, slip opinion:

The second full paragraph beginning on page 17 will be modified as follows (deletions are stricken and additions are in bold type):

> 15 U.S.C. § 78u(d) and (e) also cannot aid the SEC since the statute is not so broadly written as the SEC contends. The statute has been construed to allow the granting of "any form of ancillary relief * * * where necessary and proper to effectuate the purposes of the statutory scheme." *Materia*, 745 F.2d at 200. Language about the importance of granting complete equitable relief, however, must be read in context. Usually the language advocates that all equitable powers residing in the district court be visited upon the defendant or violator before the court. See *id.*; Farrand, *Ancillary Remedies in SEC Civil Enforcement Suits*, 89 Harv. L. Rev. 1779, (1976)[10] Nothing in the statute or case law suggests that 15 U.S.C. § 78u(d) or (e) ~~condones seeking relief from non-parties, these against whom the SEC makes no allegation of wrongdoing~~ **authorizes a court to freeze the assets of a non-party, one against whom no wrongdoing is alleged.**[11]

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[10] *Porter v. Warner Holding Co.* 328 U.S. 395, cited by the SEC (Br. 33), is not dissimilar. *Porter* involves a statutory provision in the Emergency Price Control Act of 1942 similar to the remedies provision in the Exchange Act. The Supreme Court wrote broadly about the equitable power residing in a district court adjudicating an action brought under the Emergency Price Control Act, but it held only that disgorgement of illegally obtained profits could be sought from a violator.

[11] A court can obtain equitable relief from a non-party against whom no wrongdoing is alleged if it is established that the non-party possesses illegally obtained profits but has no legitimate claim to them. Courts have jurisdiction to decide the legitimacy of ownership claims made by non-parties to assets alleged to be proceeds from securities laws violations. See *Tcherepnin v. Franz*, 485 F.2d 1251 (7th Cir. 1973) (court has jurisdiction over receiver's actions to recover ill-gotten gains from non-parties), certiorari denied, 415 U.S. 918; *SEC v. Wencke*, 783 F.2d 829

(Footnote continued on following page)

The first full paragraph on page 22 under the heading *Attorney's Fees* will be modified as follows:

Attorney's Fees

Both Sanchou and Cherif sought modification of the preliminary injunction entered against them in order to pay their respective attorney's fees. Cherif was permitted by the district court to withdraw $20,000 of the frozen funds to pay attorney's fees. Cherif argues that because he is a defendant in a pending criminal case, the injunction, which prevents him from withdrawing more funds, infringes his Sixth Amendment right to obtain counsel of his choice. **Sanchou, for his part, claims that the Fifth Amendment due process clause ensures him access to funds that will enable him to retain counsel in his civil proceeding.**[16] ~~Sanchou and~~ Cherif **also** ~~each~~ contends that the district court's refusal to modify the injunction improperly "penalizes" him for invoking the Fifth Amendment and declining to provide an accounting.

---

[11] *continued*

(9th Cir. 1986) (same), certiorari denied, 479 U.S. 818. If the non-party has no ownership interest in the disputed assets, equitable relief can be sought from the non-party. See *Deckert v. Independence Shares Corp.*, 311 U.S. 282 (as part of its equitable powers under the Securities Act of 1933, court can enjoin trustee from transferring funds belonging to company that violated Act).

The SEC may be trying to prove Sanchou's lack of ownership interest in his accounts by naming him in the complaint as a "nominal defendant." As we discuss *infra*, however, the SEC's mere assertion of Sanchou's nominal status cannot justify the entry of a freeze order. The injunction was properly issued against Sanchou only if the court on remand finds that the complaint's characterization of Sanchou as a "nominal" defendant is correct because Sanchou has no proper claim to his accounts.

[16] **Sanchou cites *Potashnick v. Port City Constr. Co.*, 609 F.2d 1101, 1117 (5th Cir. 1980), for the proposition that civil litigants have a right to counsel based in the Fifth Amendment due process clause (Br. 27). This Circuit has never adopted this ruling.**

Sanchou and Cherif cite *Federal Sav. & Loan Ins. Corp. v. Dixon*, 835 F.2d 554 (5th Cir. 1987) for the proposition that frozen fees should be released to the defendant in a civil case upon a showing that the defendant cannot pay for an attorney from exempt assets.

* * *

The second full paragraph on page 23 is revised as follows:

Because this is a civil case, the arguments of Cherif and Sanchou are weaker than were those of Chaplin & Drysdale or Monsanto. **A criminal defendant has "no Sixth Amendment right to spend another person's money for services rendered by an attorney," *Caplin & Drysdale*, 109 S. Ct. at 2652. It would be anomalous to hold that a civil litigant has any superior right to counsel than one who stands accused of a crime.** ~~There is simply no Sixth Amendment right to counsel in civil cases. The reliance of~~ Cherif**'s reliance** ~~and Sanchou on their~~ **on his** Fifth Amendment right to refuse to incriminate **himself** ~~themselves~~ is also misplaced. The Fifth Amendment may be invoked in the civil context, but unlike a criminal case, the judge sitting in the civil proceeding can draw adverse inferences from the defendant's refusal to respond to probative evidence. *Baxter*, 425 U.S. at 318. Here the district court drew adverse inferences from the defendant's' refusal to submit an accounting which would reveal which funds, if any, were not proceeds of the trading activity. We cannot say that ~~he~~ **the judge** abused his discretion in doing so.

Footnotes will be renumbered in the amended opinion to reflect the addition of the above footnotes.

Further, no judge in active service has requested a vote on the suggestion for rehearing *en banc* and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petitions for rehearing be, and the same are hereby, DENIED.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 90-1688 and 90-1805

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

DANNY O. CHERIF,

Defendant-Appellant,

and

KHALED SANCHOU,

Nominal Defendant-Appellant.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 89 C 4204—**Charles R. Norgle**, *Judge.*

ARGUED DECEMBER 13, 1990—DECIDED APRIL 29, 1991

Before CUMMINGS, COFFEY and MANION, *Circuit Judges.*

CUMMINGS, *Circuit Judge.* The Securities and Exchange Commission ("SEC") brought this civil enforcement action against defendant Danny O. Cherif, alleging that Cherif had violated the antifraud provisions of the federal securities laws, in particular Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78n(e) (1988), and Rules 10b-5 and 14e-3 thereunder. 17 C.F.R. §§ 240.10b-5 and 240.14e-3 (1990). Section 21A of the Exchange Act allows the court to enjoin further violations

of the securities laws upon a showing that defendant did in fact violate the laws or threatens to do so. 15 U.S.C. §§ 78u(d) and (e) (1988). The district court entered an injunction preventing Cherif from future trading and freezing his assets. It also froze two accounts of nominal defendant Khaled Sanchou, Cherif's cousin. It was alleged that Cherif used Sanchou's accounts to facilitate his illegal trades and that the profits from Cherif's trading remained in Sanchou's accounts. Cherif and Sanchou both appeal.

FACTS

This case, which raises for this Circuit issues of first impression in securities law, had its genesis in a simple, cunning scheme. Danny Cherif was employed by the First National Bank of Chicago ("First Chicago") in its International Financial Institutions Department from October 1979 until December 1987, when his position was eliminated as the result of an internal reorganization. When Cherif's employment with First Chicago ended, he kept his magnetic identification card. The card could be used to enter the First Chicago building if the building's security system recognized the card's owner as a current employee. Cherif's card remained activated after December 1987 because of a memorandum signed purportedly by the Senior Vice-President of the International Financial Institutions Department and sent to the bank's data-entry department. The memo, dated January 26, 1988, stated that Cherif continued to work part-time on a special project for his department and asked that his identification card remain activated. In fact, the Senior Vice-President of Cherif's department had not written or signed the memo, and Cherif was not working on a special project for First Chicago. Cherif admitted later to William Bronec, Jr., who had been a co-worker at First Chicago, that he had reactivated his identification card "by means of false representations."

Using his identification card, Cherif was able to enter the First Chicago building on nights and weekends for

over a year after his employment ended. Unbeknown to Cherif, the building's security system automatically recorded his comings and goings.

Cherif's destination within the bank was the Specialized Finance Department, which provides financing for extraordinary business transactions such as tender offers and leveraged buy-outs. The Specialized Finance Department obtained and developed confidential information about these transactions and the companies involved in the transactions from its corporate clients. In an effort to protect this information, the bank required all employees to sign an "integrity policy" restricting the use and disclosure of "material inside information" for personal gain. The policy warned that improper use of such information could result in civil or criminal penalties. Cherif had signed the agreement on three occasions, in 1979, 1986 and 1987.

A comparison of the security system's records with a summary of Cherif's trading activity revealed that during 1988 and the beginning of 1989, Cherif had traded in the stocks of four companies about which the Specialized Finance Department had obtained confidential information. For example, in May 1988, Stone Container Corp. sought First Chicago financing of a proposed acquisition of Consolidated Bathurst Corp. Cherif used his identification card to enter the building on Sunday, May 15, 1988. Cherif then bought 5500 shares of Consolidated Bathurst over the next two weeks and eventually made a profit of over $11,000. The evidence was similar with respect to the other three companies in whose stock Cherif traded. In each case, First Chicago's Specialized Finance Department had acquired confidential information about transactions and targets from a corporate client. Cherif's card was used to make an after-hours entry into the building and, soon after, Cherif bought stock in the company to be acquired or bought out. Cherif made profits on the securities of each of the four companies.

Cherif used two brokerage accounts to make his trades. He opened one brokerage account with Quick & Reilly in

March 1988 in the name of Khaled Sanchou, a resident of Tunisia and Cherif's cousin by marriage. Cherif presented to Quick & Reilly a check for $100,000 signed by Sanchou to open the account and a power of attorney authorizing Cherif to trade in Sanchou's account. Subsequently Cherif was the only person to trade in this account, and he received the monthly statements. In May 1988, Cherif opened a second brokerage account in his own name with Charles Schwab & Co. Profits from short-term securities trading in the two accounts from May 1988 to February 1989 totalled $247,000: $93,000 in the Schwab account and $154,000 in Sanchou's account at Quick & Reilly. Between February and May 1989, Cherif transferred $265,000 from the Quick & Reilly account to a bank account in Sanchou's name at First Chicago. Cherif also has a power of attorney over the First Chicago bank account.

The SEC began investigating Cherif in May 1989. They obtained the cooperation of William Bronec, Jr., a fellow employee at First Chicago until 1985. Cherif had shared the information he acquired from First Chicago with Bronec, who had become Cherif's confidant. Bronec wore a microphone to a meeting with Cherif on May 19, 1989, allowing the F.B.I to record a conversation in which Cherif admitted he had been using his card to enter the First Chicago building.

The SEC applied for an *ex parte* temporary restraining order on May 21, 1989. The SEC asked that Cherif be enjoined from further violations of the securities laws and that Cherif and Sanchou be enjoined from transferring or disposing of their assets so as to preserve the possibility of recovering civil penalties or disgorgement of illegally obtained profits. The district court entered TROs against Cherif and Sanchou. It ordered each defendant to provide an accounting showing any legitimate claim each had to his own assets. The court additionally gave permission for Sanchou to be served overseas by international express mail.

At the subsequent preliminary injunction hearing on May 31, 1989, the parties agreed to continue the TRO with respect to Cherif to allow discovery to proceed. At his deposition, Cherif did not rebut any of the SEC's evidence. Instead, he invoked his Fifth Amendment right not to incriminate himself. Cherif also failed to provide any accounting. On September 8, the district court entered a preliminary injunction against Cherif, using Cherif's silence to draw inferences adverse to him. The court found that the SEC's uncontested complaint, the record of entries into First Chicago, the trading records for the accounts in Cherif's and Sanchou's names, and the transcript of the 1989 conversation between Bronec and Cherif "constitute[d] an overwhelming *prima facie* showing of Cherif's violation." After freezing Cherif's assets, the court denied a motion that would have modified the injunction to allow Cherif to withdraw $20,000 for attorney's fees. Cherif appeals the grant of the preliminary injunction and the district court's refusal to modify the injunction.

Sanchou, for his part, did not attend the preliminary injunction hearing and filed no response to the SEC's verified complaint. The district court entered a preliminary injunction against Sanchou on the basis of his default. The injunction barred Sanchou from disposing of assets in his name or under his control. Approximately $250,000 remained in Sanchou's Quick & Reilly and First Chicago accounts. The court ordered Sanchou to provide the SEC with an accounting and prohibited him from destroying documents related to the case. Sanchou later filed an appearance and asked the district court to modify the injunction to allow him to pay reasonable attorney's fees. Sanchou also moved to vacate the preliminary injunction, arguing, *inter alia*, that he was never properly served and that, in the absence of any alleged securities violation on his part, the district court lacks subject matter jurisdiction over him. Sanchou appeals from the district court's denial of his motions to vacate and modify the preliminary injunction.

ANALYSIS

All parties apparently agree that the proper standard for the granting of a preliminary injunction is the usual one.[1] Thus plaintiff was obligated below to establish: 1) reasonable likelihood of success on the merits; 2) unavailability of a remedy at law; 3) injury to plaintiff in absence of injunction outweighing injury to defendant if injunction is granted; and 4) lack of disservice to public interest upon issuance of injunction. *Roland Machinery Co. v. Dresser Industries Inc.*, 749 F.2d 380, 386-389 (7th Cir. 1984). This Court will not set aside the issuance of an injunction absent abuse of discretion. *SEC v. Suter*, 732 F.2d 1294, 1301 (7th Cir. 1984).

Cherif

Cherif's central argument on appeal is that the SEC wrongly relied on the "misappropriation theory" to prove violations of federal securities law. Under the theory, which has been adopted by the Second, Third and Ninth Circuits, "one who misappropriates [material] non-public information in breach of a fiduciary duty and trades on that information" violates Section 10(b) and Rule 10b-5. *SEC v. Materia*, 745 F.2d 197, 203 (2nd Cir. 1984), certiorari denied, 471 U.S. 1053. See also *SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990); *Rothberg v. Rosenbloom*, 771 F.2d 818, 822 (3rd Cir. 1985), certiorari denied, 481 U.S. 1017. Cherif notes first that this Circuit has never adopted the misappropriation theory. He also argues that even if the misappropriation theory is adopted, it cannot be applied to his case.

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[1] We note that the Second Circuit has altered the standard for injunctions requested by the SEC under 15 U.S.C. §§ 78u(d) and (e). See *SEC v. Unifund SAL*, 910 F.2d 1028, 1035-1040 (2nd Cir. 1990) (SEC need not show risk of irreparable injury or unavailability of remedies at law but may be required to make a more substantial showing of likelihood of success if injunction sought will be onerous). Because the parties have not argued about the propriety of such a modification, we leave the question for another day.

Because Cherif's employment at First Chicago ended in December 1987, he believes that any fiduciary duty owed to First Chicago was extinguished at that time. Thus, Cherif argues, his subsequent conversion of information entrusted to his former employer may have amounted to theft, but it did not constitute fraud.

Cherif's first objection is easily answered because Rule 10b-5 can accommodate the misappropriation theory. Rule 10b-5 makes it unlawful for:

> any person * * * by use of any means or instrumentality of interstate commerce, or the mails or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud, * * * or
>
> (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.[2] The "classical" theory, as developed by the Supreme Court in *Chiarella v. United States*, 445 U.S. 222, and *Dirks v. SEC*, 463 U.S. 646, brings cor-

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[2] Section 10(b) of the Securities and Exchange Act of 1934 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * *
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national stock exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). The SEC promulgated Rule 10b-5 in 1942 under the authority of Section 10(b).

poration insiders and tippees of those insiders within the ambit of Rule 10b-5. Under the classical theory, a person violates the rule when he or she buys or sells securities on the basis of material, non-public information and at the same time is an insider of the corporation whose securities are traded, *Chiarella*, 445 U.S. at 227-228, or a tippee who knows or should know of the insider's breach of duty, *Dirks*, 463 U.S. at 660-661. The theory is that an insider owes a fiduciary duty to the corporation's shareholders not to trade on inside information for his personal benefit. *Chiarella*, 445 U.S. at 230 ("corporate insiders * * * have an obligation to place the shareholder's welfare before their own"). A tippee of an insider owes a fiduciary duty which is derivative of the duty owed by the insider. *Dirks*, 463 U.S. at 660 ("a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material non-public information only when the insider has breached his fiduciary duty to the shareholders").

The misappropriation theory extends the reach of Rule 10b-5 to outsiders who would not ordinarily be deemed fiduciaries of the corporate entities in whose stock they trade. The misappropriation theory focuses not on the insider's fiduciary duty to the issuing company or its shareholders but on whether the insider breached a fiduciary duty to any lawful possessor of material non-public information. In *United States v. Newman*, 664 F.2d 12 (2nd Cir. 1981), certiorari denied, 464 U.S. 863, the Second Circuit held that employees at two investment banks violated Rule 10b-5 when they "misappropriated—stole to put it bluntly" confidential information entrusted to their firm. 664 F. 2d at 17 (quoting *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting)). *Newman* held that the breach of a fiduciary duty owed by the alleged insider trader to his employer could support a Rule 10b-5 conviction, even in the absence of any duty owed by the employee or employer to the company whose shares the insider traders bought. The Court was not concerned about any fraud perpetrated on the companies whose shares were traded or on the

shareholders of those companies, as in *Dirks* or *Chiarella*.[3] Instead it was influenced by the damage inflicted on the insider trader's employer by a conniving employee. "By sullying the reputations of [their] employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money." *Newman*, 664 F.2d at 17. Trades carried out in connection with such fraud were held to be within the purview of Rule 10b-5.

Similarly, in *SEC v. Materia*, 745 F.2d 197 (2nd Cir. 1984), the employee of a financial printer was held liable under Rule 10b-5 for trading upon information the printing company had acquired in confidence from its clients. The Second Circuit found that Materia had perpetrated a fraud upon his employer by misappropriating information entrusted to the printing company. 745 F.2d at 202 ("By purloining and trading on confidences entrusted to Bowne [the printer], it cannot be gainsaid that Materia undermined his employer's integrity").

The Supreme Court has declined to comment on the viability of the misappropriation theory on two occasions. In *Chiarella*, the Court overturned the conviction of the employee of a financial printing company under Rule 10b-5, but both dissenting opinions and a concurring opinion suggested that had the misappropriation theory been presented to the jury and to the Court, the conviction might have been affirmed. See *Chiarella*, 445 U.S. at 238-239 (Brennan, J., concurring); *id.* at 245 (Burger, C.J., dissenting); *id.* at 245-246 (Blackmun, J., dissenting). In *Carpenter v. United States*, 484 U.S. 19, an equally divided Court upheld, without comment, the Rule 10b-5 conviction of R. Foster Winans, a *Wall Street Journal* columnist who had misappropriated and traded upon information contained in

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[3] The court noted that "neither [of the employers] Morgan Stanley, Kuhn Loeb nor their clients was at the time a purchaser or seller of the target company securities in any transaction with any of the defendants." *Newman*, 664 F.2d at 16.

upcoming columns.[4] The Second Circuit Court of Appeals had written perhaps its broadest affirmation of the misappropriation theory in the *Carpenter* case, explicitly rejecting any notion that "[Winans] would have to have breached a duty to the corporations or shareholders thereof whose stock they purchased or sold" to be found guilty of securities fraud. *United States v. Carpenter*, 791 F.2d 1024, 1029 (2nd Cir. 1986).

The misappropriation theory has won adherents in numerous circuit and district courts despite the lack of explicit approval from the Supreme Court. The bulk of the cases have arisen in the Second Circuit, see *Newman*, 664 F.2d at 12; *Materia*, 745 F.2d at 197; *Carpenter*, 791 F.2d at 1024; *SEC v. Tome*, 638 F.Supp. 596 (S.D.N.Y. 1986), affirmed, 833 F.2d 1086 (2nd Cir. 1987); *SEC v. Musella*, 578 F.Supp. 425 (S.D.N.Y. 1984); *United States v. Willis*, 737 F.Supp. 269 (S.D.N.Y. 1990), but the theory has now been adopted by the Third and Ninth Circuits. See *Clark*, 915 F.2d at 439; *Rothberg*, 771 F.2d at 818. District courts in other circuits have welcomed the theory,

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[4] The Supreme Court has suggested in *dicta* that one subset of traditional outsiders may be liable under Rule 10b-5 directly as "quasi-insiders" rather than through the use of the misappropriation theory. In *Dirks*, the Court wrote in a footnote that:

> Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.

Dirks, 463 U.S. at 655, n. 14. Under this *dicta* presumably someone who worked for First Chicago might be deemed to have a direct fiduciary duty to the shareholders of the client company. Because neither the Supreme Court nor the Courts of Appeals have explicitly adopted the "quasi-insider" theory of liability, however, we decline to apply it to this case.

too. *SEC v. Peters*, 735 F.Supp. 1505 (D.Kan. 1990); *United States v. Elliott*, 711 F.Supp. 425 (N.D.Ill. 1989).

We join these courts in holding that a person violates Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934 by misappropriating and trading upon material information entrusted to him by virtue of a fiduciary relationship such as employment. There is a common sense notion of fraud behind the misappropriation theory. As the *Clark* court put it:

> [B]y becoming part of a fiduciary or similar relationship, an individual is implicitly stating that she will not divulge or use to her own advantage information entrusted to her in the utmost confidence. She deceives the other party by playing the role of the trustworthy employee or agent; she defrauds it by actually using the stolen information to its detriment.

Clark, 915 F.2d at 448. We agree that buying or selling securities "in connection with" fraud perpetrated on an employer to obtain material non-public information constitutes a violation of Rule 10b-5.[5]

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[5] The more precise issues of statutory construction and legislative history have been treated exhaustively elsewhere, and we decline to revisit them. There is little question that the vague term "fraud" as used in Section 10(b) and Rule 10b-5 can encompass the misappropriation theory. See *Materia*, 745 F.2d at 201 (misappropriation "falls squarely within the 'fraud or deceit' language of the rule"); *Clark*, 915 F.2d at 449 ("misappropriation theory fits comfortably within the meaning of 'fraud' in § 10(b) and Rule 10b-5"). In addition, interpreting Rule 10b-5 to include the misappropriation theory plainly effectuates the broad purposes behind the securities laws. *Newman*, 664 F.2d at 18-19 (investor protection is not sole aim of securities statutes, rather, statutes represent effort to achieve high standard of business ethics in "every facet of the securities industry"); *Materia*, 745 F.2d at 201 (Section 10(b) "not aimed solely at the eradication of fraudulent trading by corporate insiders").

We note also that Congress has endorsed the misappropriation theory in discussions of the Insider Trading Sanctions Act of 1984

(Footnote continued on following page)

The only possible barrier to application of the misappropriation theory to Cherif's case is, as Cherif points out, the fact that his employment with First Chicago ended before he stole and traded upon inside information. Cherif argues that no fiduciary duty existed between him and his employer at any time after December 1987, when he began to obtain information about upcoming transactions from the Specialized Finance Department.

As an initial matter, Cherif misconstrues the nature of his duty to First Chicago. He argues that the terms of the bank's "integrity policy" only prevented him from using information specifically about future transactions obtained while he was on the job. He also believes that the use of such inside information was restricted only to the term of his employment.

Notwithstanding the contractual agreement, Cherif was bound by a broader common law duty. This common law duty obligates an employee to protect any confidential information entrusted to him by his employer during his employment. In addition, an employee is obligated to continue to protect such information after his termination. The Restatement (Second) of Agency § 395 (1958), provides:

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[5] *continued*

and the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"). The House Report accompanying the insider trading bill in 1984, which amended certain provisions of the 1934 Act, noted that "deceitful misappropriation of confidential information by a fiduciary" has consistently been held to be unlawful in various areas of the law. H.R. Rep. No. 355, 98th Cong., 2d Sess. 4, *reprinted in* 1984 U.S. Code Cong. & Admin. News 2274, 2278. The report continued, "Congress has not sanctioned a less rigorous code of conduct under the federal securities laws." *Id.* In 1988, the House Committee reporting on the ITSFEA wrote about misappropriation that "this type of security fraud should be encompassed within Section 10(b) and Rule 10b-5." H.R. Rep. No. 910, 100th Cong., 2d Sess. *reprinted in* 1988 U.S. Code Cong. & Admin. News 6043, 6047.

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency * * * in competition with or to the injury of the principal, * * * unless the information is a matter of general knowledge.

This principle prevents former employees from divulging trade secrets, for example. See, *e.g.*, *AMP Inc. v. Fleischhacker*, 823 F.2d 1199, 1202 (7th Cir. 1987) (applying Illinois law directing that "an employee may not take with him confidential, particularized plans or processes * * * disclosed to him while the employer-employee relationship existed"); *In re Innovative Constructive Systems*, 793 F.2d 875, 880 (7th Cir. 1986) (applying Wisconsin law stating that departing employee may not take "with him * * * trade secrets or processes * * * wrongfully appropriated").

First Chicago did convey confidential property and information to Cherif during his employment. Cherif focuses exclusively on information regarding specific upcoming deals, which he did not obtain until after December 1987. First Chicago entrusted Cherif with other confidential information, however. He was given a key card that was issued to him solely because of his status as an employee. Cherif possessed specific knowledge about the internal procedures of the bank. Recognizing the value of this knowledge, First Chicago in its "integrity policy" explicitly identified its "internal policies" as confidential information which "should not * * * be utilized for personal gain" (R. Item 119, App. C). Despite this restriction, Cherif combined his knowledge of the appearance of his boss's signature and the "internal policy" concerning how requests for continued activation of his key card would be handled by First Chicago to effect his scheme. Cherif also knew where within the bank's non-public offices to find information relating to upcoming transactions.

Cherif breached a continuing duty to his former employer when he used the key card and specific, confidential knowl-

edge he had learned about First Chicago as an employee to break into the bank immediately after termination and steal inside information about upcoming transactions. It makes no difference that Cherif carried out the thefts formally after his employment ended. The confidential property and information he came to possess during his tenure at the bank provided the foundation for the success of the subsequent break-ins. Cherif attained his objective of obtaining deal-specific information by wrongfully converting other confidential information entrusted to him by First Chicago. His trades were "in connection with" a fraudulent scheme to gain access to material, non-public information possessed by First Chicago. This is all the nexus that Rule 10b-5 requires.

Cherif betrayed a trust in a way that a mere thief does not.[6] He used property and information belonging to First Chicago, and made available to him only through his fiduciary relationship, against the bank's own interests. His actions were fraudulent in the common understanding of the word because they deprived some person of something of value by "trick, deceit, chicane or overreaching."[7] *McNally v. United States*, 483 U.S. 350, 358, quoting *Hammerschmidt v. United States*, 265 U.S. 182, 188. Cherif may

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[6] There has been some suggestion that Rule 10b-5 should apply even to "mere" thieves. See *Chiarella*, 445 U.S. at 246 (Blackmun, J., dissenting) (suggesting that any time information is acquired by an illegal act, whether in breach of a fiduciary duty or not, there is a duty to disclose that information to the purchaser or seller with whom the acquirer trades); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 n.22 (suggesting that trading on "misappropriate[d] or illegally obtain[ed]" information constitutes fraud in violation of Rule 10b-5). We need not reach this question because of our holding that Cherif breached a fiduciary duty owed to First Chicago.

[7] The mere fact that Cherif obtained entry by representing that he continued to work at the bank when in fact he had been discharged would constitute a breach of fiduciary duty. The Restatement (Second) of Agency § 385 (1958) provides that: "Unless otherwise agreed, an agent is subject to a duty not to act as such after the termination of authority."

have eroded client confidence in First Chicago, by suggesting the company's susceptibility to treachery from within. See *Newman*, 664 F.2d at 17. We have little difficulty concluding that his course of conduct was fraudulent within the meaning of Rule 10b-5.

Cherif's remaining arguments do not merit extensive discussion. For example, he calls attention to the SEC's inability to produce First Chicago documents with his fingerprints on them or surveillance films of him inside the bank. But Cherif's argument as to the sufficiency of the evidence ignores the evidence that the district court did consider. The SEC made available the tape of the conversation between Bronec and Cherif in which Cherif admitted he illegally entered the bank and proclaimed that if the bank found out about his key card, "I'm probably screwed." The court had a transcript of Bronec's plea agreement in which he recounted how Cherif had admitted reviewing documents in the Specialized Finance Department.[8] The SEC also submitted the bank's records of Cherif's weekend and late-night entries. All of this evidence remains unrebutted at this point because Cherif invoked the Fifth Amendment. The district court permissibly drew inferences from Cherif's refusal to respond to probative evidence in this civil proceeding, see *Baxter v. Palmigiano*, 425 U.S. 308, 318, and found that the SEC had presented evidence establishing that violations of the securities laws had occurred.

Cherif also argues that the information he obtained was not non-public. This argument is disproved by the evidence the SEC has offered. The bank protected the confidentiality of the information entrusted to it in connection with proposed extraordinary transactions by, for example, formulating the "integrity policy." The bank treated all information received from clients as confidential, and at times even gave code names to the corporate entities involved in the proposed transactions. As the SEC points

[8] Cherif argues that the plea agreement was inadmissible hearsay. However, hearsay can be considered in entering a preliminary injunction. See *Asseo v. Pan American Grain Co.*, 805 F.2d 23, 26 (1st Cir. 1986).

out, the fact that a client is considering the acquisition of some other corporation can itself be critical, non-public information. *Materia*, 745 F.2d at 199 ("Because even a hint of an upcoming tender offer may send the price soaring, information regarding the identity of a target is extremely sensitive and zealously guarded").

Finally, Cherif contends that the information was not material, mainly because it was too speculative to assume "actual significance in the deliberations of the reasonable shareholder" or investor. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449. The information stored in the Specialized Finance Department about the four companies in whose stock Cherif traded was clearly material. It included the identities of proposed targets and proposed terms for acquisitions and management buy-outs, including proposed price ranges. Such information satisfies the materiality requirement of Rule 10b-5. *Clark*, 915 F.2d at 441 (identity of target and price to be offered by acquirer are material information); *Materia*, 745 F.2d at 199 (identities of four tender offer targets discerned in spite of use of code names are material).

The district court did not abuse its discretion in granting a preliminary injunction with respect to Cherif.[9] It made no errors of law and its factual findings are well supported. We will discuss the propriety of modifying the injunction to allow Cherif to pay attorney's fees after addressing Sanchou's arguments.

Sanchou

Sanchou advances a host of arguments, the most troubling of which is the question of subject matter jurisdiction. Sanchou has not been accused of violating any se-

[9] We need not consider whether Cherif violated SEC Rule 14e-3, which prohibits trading while in possession of material, non-public information relating to a tender offer. 17 C.F.R. § 240.14e-3. A showing that Cherif violated Rule 10b-5 is sufficient to uphold the issuance of the injunction.

curities laws (Appellee's Br. at 35). This would seem to make issuance of a preliminary injunction against Sanchou impossible because 15 U.S.C. § 78u(d) specifies that only a person who "is engaged or is about to engage in acts constituting a violation" of the securities laws can be enjoined. The SEC contended initially in its verified complaint that jurisdiction over Sanchou is "necessary and appropriate" pursuant to Fed. R. Civ. P. 19(a) because Sanchou's participation will enable the court to grant complete relief. The SEC argues before this Court that jurisdiction over Sanchou is proper directly under 15 U.S.C. §§ 78u(d) and (e). The SEC believes that the statute authorizes the granting of any kind of ancillary relief, even against third parties, once a violation by one person has been established (Br. at 32-33).

The SEC is understandably anxious to recover Cherif's ill-gotten gains, but neither of the SEC's arguments can support an exercise of jurisdiction over Sanchou to justify divesting him of the funds now in his accounts. Rule 19 alone cannot give the district court subject matter jurisdiction over the dispute with Sanchou because Rule 19 is not a source of federal jurisdiction. *Graf v. Elgin, Joliet & Eastern Railway Co.*, 697 F.2d 771, 775 (7th Cir. 1983). The rule supplies a mechanism by which interested parties can be joined, but it presumes the preexistence of subject matter jurisdiction over some cause of action alleged against the defendant. Subsection (b) of Rule 19 even directs that in cases where subject matter jurisdiction (*i.e.* diversity) would be destroyed by joinder of the "necessary" party, the court must contemplate dismissing the original action.

15 U.S.C. §§ 78u(d) and (e) also cannot aid the SEC since the statute is not so broadly written as the SEC contends. The statute has been construed to allow the granting of "any form of ancillary relief * * * where necessary and proper to effectuate the purposes of the statutory scheme." *Materia*, 745 F.2d at 200. Language about the importance of granting complete equitable relief, however, must be read in context. Usually the language advocates that all equitable powers residing in the district

court be visited upon the defendant or violator before the court. See *id.*; Farrand, *Ancillary Remedies in SEC Civil Enforcement Suits*, 89 Harv. L. Rev. 1779 (1976). Nothing in the statute or case law suggests that 15 U.S.C. § 78u(d) or (e) condones seeking relief from non-parties, those against whom the SEC makes no allegation of wrongdoing.

The foregoing is not meant to suggest that there is no way to recover the funds in Sanchou's accounts.[10] Two possibilities present themselves. First, the SEC could make use of the rather obscure common law concept of the "nominal defendant." Sanchou has, after all, been named in that capacity. This option is explored in more detail below. Alternatively, the SEC could simply make Sanchou a full defendant by asserting that he either violated or aided or abetted a violation of the securities laws. The problem thus far is that the SEC has pursued each of these contradictory theories of recovery at once.

A "nominal defendant" is a person who can be joined to aid the recovery of relief without an assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation.[11] A nominal defendant holds the subject matter of the litiga-

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[10] Why the SEC did not try to attach the funds directly is a mystery. Fed. R. Civ. P. 64 makes available those remedies used to secure satisfaction of a judgment "in the circumstances and manner provided by the law of the state in which the district court is held." Before this Court the SEC argues that a constructive trust might be imposed in favor of the injured investors under Illinois state law. Apparently the viability of this option was not explored by the district court and thus will not be considered.

[11] By definition a nominal defendant cannot be a "necessary" or "indispensable" party, as those terms are used in Fed. R. Civ. P. 19. See *Salem Trust Co. v. Manufacturers' Finance Co.*, 264 U.S. 182, 188-200 (contrasting indispensable parties with mere nominal parties). A necessary party is one who "claims an interest relating to the subject of the action." Fed. R. Civ. P. 19(a). A nominal defendant, as will be explained, has no interest in the property that is the subject of the litigation.

tion "in a subordinate or possessory capacity as to which there is no dispute." *Colman v. Shimer*, 163 F.Supp. 347, 351 (W.D.Mich. 1958) (quoting 2 J. Palmer, Cyclopedia of Federal Procedure, § 3.63 (3rd ed.)). Because the nominal defendant is a "trustee, agent, or depositary," *id.*, who has possession of the funds which are the subject of litigation, he must often be joined purely as a means of facilitating collection. The court needs to order the nominal defendant to turn over funds to the prevailing party when the dispute between the parties is resolved. A nominal defendant is not a real party in interest, however, because he has no interest in the subject matter litigated. His relation to the suit is merely incidental and "it is of no moment [to him] whether the one or the other side in [the] controversy succeed[s]." *Bacon v. Rives*, 106 U.S. 99, 104. Because of the non-interested status of the nominal defendant, there is no claim against him and it is unnecessary to obtain subject matter jurisdiction over him once jurisdiction over the defendant is established. *Farmers' Bank v. Hayes*, 58 F.2d 34, 36 (6th Cir. 1932).

We cannot deem the nature of Sanchou's interest in the funds in his accounts to be so subordinate that treatment of Sanchou as a nominal defendant is justified. The facts in the record on appeal are inconclusive. Some facts suggest that the funds in Sanchou's Quick & Reilly and First Chicago accounts are really Cherif's. Cherif had a power of attorney over each account. At the time he was trading, he used the accounts exclusively. His "industry" was the source of the funds added to the initial deposit.

Other facts, however, suggest that Sanchou's claim of title to the funds is not a sham and that Sanchou might even have helped Cherif to carry out his scheme. Sanchou supplied the $100,000 check used to open the Quick & Reilly account. On the day after the temporary restraining order was entered, Sanchou attempted to have the funds in the accounts wired overseas. These facts imply that it might be appropriate to name Sanchou outright as a defendant.

The district court's findings do not answer the question of whether Sanchou should be treated: 1) as a nominal

defendant against whom the SEC need not assert an independent basis of subject matter jurisdiction; or 2) as a defendant against whom the SEC can or must bring a claim. The court first untenably suggested that Rule 19 supported the exercise of jurisdiction over Sanchou (R. Item 30 at 1) (Order Entering Preliminary Injunction as to Khaled Sanchou). The court also seemed to accept the theory that Sanchou himself is a wrongdoer, however, in spite of the fact that the SEC never formally alleged this. It found that "Sanchou, directly or indirectly, has made use of the means and instrumentalities of interstate commerce * * * in connection with the acts, practices, and courses of business described below [the alleged illegal trades]" (R. Item 30 at 3).

We will allow the injunction to remain in effect for 14 days so that Sanchou's and Cherif's respective rights in the accounts and Sanchou's party status can be sorted in an evidentiary hearing. Although we express no opinion as to what the finding of the district court may be, it seems from the facts adduced to this point that two outcomes are possible. If Sanchou's accounts were never meant to be anything but the means for Cherif to carry out his scheme,[12] the injunction is valid because Sanchou is prop-

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[12] *International Controls Corp. v. Vesco*, 490 F.2d 1334 (2nd Cir. 1974), certiorari denied, 417 U.S. 932, is instructive concerning the evidence that can be brought forth in an evidentiary hearing to support the issuance of an injunction against a non-party under 15 U.S.C. §§ 78u(d) and (e). In *Vesco*, the district court issued an injunction preventing Andean Credit Co., a non-defendant, from removing a yacht from its berth. Though Andean claimed title to the yacht, the plaintiff alleged that the yacht in fact was an asset of Robert Vesco, the defendant and insider trader. The Second Circuit upheld the injunction after the plaintiff, in an evidentiary hearing, "made a sufficient showing of Vesco's interest in the yacht to sustain the injunctive relief granted." *Vesco*, 490 F.2d at 1355. Plaintiff demonstrated that Vesco and other defendants controlled Andean and may have been the actual source of the funds used to purchase the yacht, that Vesco and his family were the sole users of the yacht, and that Vesco had paid to refurbish the yacht. The court concluded, "One thing appears clear: Andean performed no function other than that of a mere nominee or shell." *Id.*

erly termed a "nominal defendant." If Sanchou, as some of the facts suggest and as the district court seems to believe, is himself implicated in Cherif's scheme, the injunction must be vacated. The SEC would have to amend its complaint promptly to state a claim directly against Sanchou to recover the monies held in his accounts. It can then seek a new injunction under the amended complaint.

In any event, the SEC must take a stance on Sanchou's status. It cannot continue to name Sanchou as a "nominal defendant" to excuse itself from having to establish subject matter jurisdiction, while at the same time implying strongly that Sanchou is a violator of the securities laws. If Sanchou is a defendant, the district court should make him one. He will then be apprised of the nature of the allegations against him and can make use of the possible defenses available to him under the securities laws. Until now, Sanchou has been deprived of the use of what is arguably his money though no one has established either that he is a wrongdoer or that the money simply is not his.

If the district court finds that Sanchou is a nominal defendant, the injunction can remain in effect because Sanchou's other challenges to the grant of the injunction are meritless.[13] Sanchou argues at length that he was never properly served with process in Tunisia and that he received inadequate notice of the May 31 preliminary injunction hearing at which he defaulted. We need not rule on the

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[13] Sanchou argues that the scope of the injunction must be modified even if it remains in effect after a finding that he acted as Cherif's nominee. We note initially that any funds which are found to be Sanchou's rather than Cherif's must be excluded from the freeze order. The district court may find, for example, that the initial $100,000 deposit was composed exclusively of Sanchou's funds. Funds in the accounts which are found to be Sanchou's only in name, however, can be frozen to satisfy a judgment against Cherif. The dollar figure of the assets frozen can include the amount of proceeds reasonably subject to disgorgement plus the amount which the SEC can recover as a civil penalty. *SEC v. Unifund SAL*, 910 F.2d 1028, 1041-1042 (2nd Cir. 1990).

adequacy of service of process or notice in this case, however, because Sanchou waived the argument below.

It is axiomatic that a party waives a defense of insufficiency of process by failing to assert it seasonably in a motion or his first responsive pleading. Fed. R. Civ. P. 12(h)(1); *Giotis v. Apollo of Ozarks, Inc.*, 800 F.2d 660, 663 (7th Cir. 1986), certiorari denied, 479 U.S. 1092. Sanchou defaulted at the preliminary injunction hearing. Sanchou's first responsive pleading, a motion to amend the preliminary injunction, was filed on July 17, 1989. In this motion, Sanchou made no argument that he had not been timely served. In fact he himself invoked the jurisdiction of the court to ask for an order which would allow him to pay reasonable attorney's fees. In these circumstances, Sanchou's arguments regarding proper service of process and notice do not remain viable.

The injunction against Sanchou will remain in effect for 14 days so that the district court can hold an evidentiary hearing to determine the proper capacity in which Sanchou should be sued. If the court finds that he is a nominal defendant, the injunction was properly issued. If the court determines that Sanchou must be sued as a defendant, the complaint should be amended. The SEC can seek a new injunction invoking 15 U.S.C. §§ 78u(d) and (e) directly.

Attorney's Fees

Both Sanchou and Cherif sought modification of the preliminary injunctions entered against them in order to pay their respective attorney's fees. Cherif was permitted by the district court to withdraw $20,000 of the frozen funds to pay attorney's fees. Cherif argues that because he is a defendant in a pending criminal case, the injunction, which prevents him from withdrawing more funds, infringes his Sixth Amendment right to obtain counsel of his choice. Sanchou and Cherif each contend that the district court's refusal to modify the injunction improperly "penalizes" him for invoking the Fifth Amendment and declining to provide an accounting. Sanchou and Cherif cite *Federal*

Sav. & Loan Ins. Corp. v. Dixon, 835 F.2d 554 (5th Cir. 1987), for the proposition that frozen fees should be released to the defendant in a civil case upon a showing that the defendant cannot pay for an attorney from exempt assets.

We review a district court's refusal to modify an injunction using an abuse of discretion standard, *Money Store, Inc. v. Harriscorp Finance Inc.*, 885 F.2d 369, 372 (7th Cir. 1989), and find no abuse of discretion in this record. The recent Supreme Court cases of *Caplin & Drysdale, Chartered v. United States*, 109 S. Ct. 2646, and *United States v. Monsanto*, 491 U.S. 600, held that the use of frozen assets for attorney's fees could be disallowed in circumstances much more extreme than in *Dixon* or in this case. Both cases involved a criminal drug forfeiture statute, 21 U.S.C. § 853(e)(1)(A), which authorizes the forfeiture of property derived from or constituting proceeds from drug law violations. The Court held in *Caplin & Drysdale* that the Sixth Amendment right to counsel is not implicated when a district court refuses to release funds forfeited under the statute to allow a criminal defendant to pay attorney's fees. *Monsanto* held in addition that a defendant's assets may be frozen before conviction based on a finding of probable cause to believe the assets are forfeitable. *Monsanto*, 109 S. Ct. at 2665-2667.

Because this is a civil case, the arguments of Cherif and Sanchou are weaker than were those of the defendants in *Caplin & Drysdale* or *Monsanto*. There is simply no Sixth Amendment right to counsel in civil cases. The reliance of Cherif and Sanchou on their Fifth Amendment right to refuse to incriminate themselves is also misplaced. The Fifth Amendment may be invoked in the civil context, but unlike a criminal case, the judge sitting in the civil proceeding can draw adverse inferences from the defendant's refusal to respond to probative evidence. *Baxter*, 425 U.S. at 318. Here the district court drew adverse inferences from the defendants' refusal to submit an accounting which would reveal which funds, if any, were not proceeds of the trading activity. We cannot say that he abused his discretion in doing so.

CONCLUSION

For the foregoing reasons, the district court's grant of the injunction with respect to Cherif, and its refusal to modify the injunction, is affirmed. The case is remanded with instructions, however, for further consideration of whether Sanchou properly can be enjoined and, if so, whether modification of the existing injunction to exclude non-proceeds is necessary.

Appellants' motion to strike matters from the SEC brief was taken with the case and is hereby denied.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case Number: 89 C 4204 Date: MAY 21, 1989

Name of Assigned Judge: CHARLES R. NORGLE SR.
Name of Sitting Judge: MARVIN E. ASPEN

Case Title: Securities & Exchange Commission v. Danny O. Cherif and Khaled Sanchou

* * * * *

DOCKET ENTRY:

(1) ☐ Judgment is entered as follows:

(2) ☒ [Other docket entry:]

Enter Temporary Restraining Order: It is hereby ordered that the defendants, and each of them, show cause, if there be any, to this Court at 10:00 a.m. on the 31st of May, 1989, in Room 1703, before the Honorable Charles R. Norgle, Sr., U.S. District Judge, at 219 S. Dearborn, as soon thereafter as they can be heard, why this Court should not enter a preliminary injunction and order preliminary relief against the defendants pursuant to Rule 65, enjoining each of them from further violations of Sections 10(b) and 14(e) of the Exchange Act. This temporary restraining order shall be in effect to and including May 31, 1989, at 10:45 a.m., unless extended by order of Court.

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(12) ☒ (For further detail see

☐ order on the reverse of

☒ order attached to the original minute order form.)

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[DATED MAY 21, 1989]

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION 450 Fifth Street, N.W. Washington, D.C. 20549 (202) 272-2242 Plaintiff, -v- DANNY O. CHERIF Defendant. and KHALED SANCHOU Nominal Defendant.	89 CIV. NO. 4204 (1) TEMPORARY RESTRAINING ORDER, AND ORDERS (2) TO SHOW CAUSE, (3) FREEZING ASSETS, (4) FOR AN ACCOUNTING, (5) FOR EXPEDITED DISCOVERY, (6) MAKING SPECIAL APPOINTMENTS TO SERVE PROCESS, (7) DIRECTING EXTRATERRITORIAL SERVICE OF PROCESS AND (8) PREVENTING DOCUMENT ALTERATION OR DESTRUCTION

On the Application of Plaintiff Securities and Exchange Commission ("Commission") for: a Temporary Restraining Order; an Order to Show Cause Why a Preliminary Injunction Should Not be Issued against the Defendants; an Order Freezing Certain Assets; an Order for an Accounting; an Order for Expedited Discovery; an Order Making Special Appointments to Serve Process; an Order Directing Extraterritorial Service of Process; and an Order Preventing Document Alteration or Destruction, the Court has considered the Verified Complaint in this action filed by the Commission on May 22, 1989, and the

exhibits attached thereto, and the Memorandum of Points and Authorities in Support of the Application. Based upon the above-described documents, the Court is satisfied that the Commission has made a sufficient and proper showing in support of the relief granted herein, as required by Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78u(d)], for the following reasons:

1. It appears from the evidence presented that defendants Danny O. Cherif ("Cherif") directly or indirectly, has engaged, is engaged, and is about to engage in acts, practices, and courses of business, in connection with the purchase and sale of securities, which have constituted, constitute and will constitute violations of Sections 10(b) and 14(e) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78n(e)] and Rules 10b-5 and 14e-3 [17 C.F.R. §§ 240.10b-5 and 240.14e-3] promulgated thereunder.

2. It further appears that the defendant, acting singly and in concert, realized on behalf of himself and caused others to realize more than $350,000 in illegal profits as a result of such trading activity.

3. It further appears that the defendant may be liable for civil penalties in an amount equal to as much as three times the total profits derived from such trading activity as occurred on and after May 24, 1989, pursuant to the Insider Trading Sanctions Act of 1984, Section 21(d)(2)(a) of the Exchange Act [15 U.S.C. § 78u(d)(2)(a)].

4. It further appears that the defendant may attempt to dissipate, conceal or transfer from the jurisdiction of this Court or outside the United States, funds and other assets which could be subject to an order of disgorgement or an order to pay civil penalties.

5. It further appears that the defendant may attempt to alter or destroy documents which may be evidence in this action.

6. It further appears that nominal defendant Khaled Sanchou ("Sanchou") resides in Tunisia. The method of service set forth in Section IX of this Order is the method most likely to comply with the laws of Tunisia to give effective notice to nominal defendant Sanchou of this Order and the Summons and Complaint.

7. This Court has jurisdiction over the subject matter of this action and over the defendants, and venue properly lies in this district.

NOW THEREFORE,

I.

IT IS HEREBY ORDERED that the defendants, and each of them, show cause, if there be any, to this Court at 10:00 o'clock in the A.M., on the 31 day of May, 1989, in Room ____ of the Judge to whom this case is assigned at the time of filing, of the United States District Court for the Northern District of Illinois, 219 South Dearborn Street, Chicago, Illinois, as soon thereafter as they can be heard, why this Court should not enter a preliminary injunction and order preliminary relief against the defendants pursuant to Rule 65 of the Federal Rules of Civil Procedure, enjoining each of them from further violations of Sections 10(b) and 14(e) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78n(e)] and Rules 10b-5 and 14e-3 [17 C.F.R. §§ 240.10b-5 and 240.14e-3] promulgated thereunder.

II.

IT IS FURTHER ORDERED that the defendants show cause at that time why this Court should not order: (a) that the defendants, their officers, directors, agents, servants, employees, attorneys, and those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and

each of them, hold and retain within their control, and otherwise prevent any disposition, transfer or dissipation whatsoever of any assets, funds or other property presently held by them, under their control or over which they exercise actual or apparent investment or other authority and in whatever form such assets may presently exist; and (b) that any financial or brokerage institutions or other person or entity holding any funds or other assets in the name, for the benefit or under the control of any defendant, or in the name, for the benefit or under the control of any person or entity listed in Attachment A to this order, shall hold and retain within its control and prohibit the withdrawal, removal, transfer or other disposal of any such funds or assets.

III.

IT IS FURTHER ORDERED that, pending the determination of the Commission's Application for a Preliminary Injunction, defendant Danny O. Cherif, his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and each of them, be and hereby are temporarily restrained and enjoined from violating Section 10(b) of the Exchange Act (15 U.S.C. §§ 78j(b)) and Rule 10b-5 (17 C.F.R. §§ 240.10b-5)) promulgated thereunder, by directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) employing any device, scheme or artifice to defraud;

(b) making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in the light

of the circumstances under which they were made, not misleading; or

(c) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

IV.

IT IS FURTHER ORDERED that, pending the determination of the Commission's Application for a Preliminary Injunction, defendant Danny O. Cherif, his officers, servants, employees, attorneys, and those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and each of them, be and hereby are temporarily restrained and enjoined from violating Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)] and Rule 14e-3 [17 C.F.R. § 240.14e-3] promulgated thereunder, by directly or indirectly, in connection with any tender offer or request or invitation for tenders, engaging in any fraudulent, deceptive, or manipulative act or practice by:

(a) trading in the securities sought or to be sought in the tender offer while in possession of material information relating to said tender offer which they know of have reason to know is nonpublic and know or have reason to know was acquired directly or indirectly from the offering person, the issuer of the securities sought or to be sought in such tender offer, or any officer, director, partner, employee or other person acting on behalf of the offering person or such issuer, without disclosing such information and its source a reasonable time prior to trading; or

(b) communicating material information relating to a tender offer, which information they know or have reason to know is nonpublic and know or have reason to know was acquired directly or indirectly from the offering person, the issuer of the securities sought or to be sought in the tender offer, or any person acting on behalf of the offering person or such issuer, to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in violation of Rule 14e-3 [17 C.F.R. § 240.14e-3], promulgated under Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)].

V.

IT IS FURTHER ORDERED that, pending determination of the Commission's request for a Preliminary Injunction, defendant Danny O. Cherif, his officers, agents, servants, employees, attorneys, those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and each of them, shall hold and retain within their control, and otherwise prevent any concealment, disposition, transfer or dissipation whatsoever of any assets, funds or other property presently held in the name of Danny O. Cherif, for his benefit or under his control or over which he exercises actual or apparent investment or other authority; and each of the financial and brokerage institutions or other persons presently holding such assets, funds or other property shall hold and retain within its control and prohibit the withdrawal, removal, transfer or other disposal of any of the assets, funds or other property presently held in the name, for the benefit or under the control of Danny O. Cherif.

VI.

IT IS FURTHER ORDERED that, pending determination of the Commission's request for a Preliminary Injunction, nominal defendant Khaled Sanchou, his officers, agents, servants, employees, attorneys, those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and each of them, shall hold and retain within their control, and otherwise prevent any concealment, disposition, transfer or dissipation whatsoever those assets, funds or other property presently held in the name of Khaled Sanchou, for his benefit or under his control or over which he exercises actual or apparent investment or other authority; and each of the financial and brokerage institutions or other persons presently holding such assets, funds or other property shall hold and retain within its control and prohibit the withdrawal, removal, transfer or other disposal of any of the assets, funds or other property presently held in the name, for the benefit or under the control of Khaled Sanchou.

VII.

IT IS FURTHER ORDERED that, pending determination of the Commission's request for a Preliminary Injunction, Cherif and Sanchou, their officers, agents, servants, employees, attorneys, and those persons in active concert or participation with them who receive actual notice of this order by personal service or otherwise, and each of them, are hereby enjoined from destroying, mutilating, concealing, altering or disposing of any items including but not limited to any books, records, documents, contracts, agreements, assignments, obligations or other property of the defendants herein, relating to the defendants or any of their securities or financial or business dealings.

VIII.

IT IS FURTHER ORDERED that each of the defendants shall, within three (3) business days of the service of this Order, file with this Court and serve upon the Commission, at the address set forth in Paragraph XI below, an accounting of:

(a) all securities, funds or other assets of each defendant held in his name or in which he or it has any direct or indirect beneficial interest, from April 1, 1988 to the present, stating the location and disposition of each of such assets;

(b) each account with any financial institution or brokerage firm maintained in his name or in which he has any direct or indirect beneficial interest or over which he exercised actual or apparent control or investment authority, from April 1, 1988, to the present, including but not limited to each account through which he directed securities transactions at any time since April 1, 1988, or in which the proceeds from such transactions were held;

(c) all transactions and the disposition of the proceeds of such transactions in securities conducted in each account identified in response to subparagraph (b) of this paragraph; and

(d) every transaction from April 1, 1988, to the present in which any funds or other assets of any kind were transferred from either defendant to the other defendant in this action.

IX.

IT IS FURTHER ORDERED that the Commission's application for expedited discovery is granted and that,

commencing with the time and date of this Order, in lieu of the time periods and notice provisions of Rules 30, 33, 34 and 36 of the Federal Rules of Civil Procedure, discovery shall proceed as follows:

A. Pursuant to Rule 30(a) of the Federal Rules of Civil Procedure the Commission may take depositions upon oral examination, subject to two (2) days notice of any such deposition.

B. Pursuant to Rule 33(a) of the Federal Rules of Civil Procedure, the defendants shall answer all of the Commission's interrogatories within two (2) days of service of such interrogatories;

C. Pursuant to Rule 34(b) of the Federal Rules of Civil Procedure, defendants shall produce all documents requested by the Commission within two (2) days of service of such request;

D. Pursuant to Rule 36(a) of the Federal Rules of Civil Procedure, the defendants shall answer all of the Commission's requests for admissions within two (2) days of such requests; and

E. All written responses to the Commission's requests for discovery under the Federal Rules of Civil Procedure shall be delivered to the Commission at 219 South Dearborn Street, Room 1204, Chicago, Illinois 60604, to the attention of Gregory von Schauburg, Esquire, or such other place as counsel for the Commission may direct in writing by the most expeditious means available.

X.

A. IT IS FURTHER ORDERED that service of this Order and the Commission's Application, along with all supporting documents, including the Summons and Complaint shall be made upon Cherif or his attorneys on or

before the 23 day of May, 1989. Service may be made personally or by mail upon defendants of their attorneys by representatives of the Commission, representatives of the United States Postal Service, federal marshals, any other qualified person over the age of 21 years, or by an alternative provision for service permitted by Rule 4 of the Federal Rules of Civil Procedure or as this Court may otherwise direct.

B. IT IS FURTHER ORDERED that, with respect to nominal defendant Khaled Sanchou, the Commission shall serve Sanchou in Tunisia by international express mail, if within five days Commission counsel is able, through investigation or deposition, to determine Sanchou's home or business address; otherwise by publication in a newspaper of general circulation in the city of his residence, if that can be learned, or in Tunis, the capital city.

XI.

IT IS FURTHER ORDERED that the defendants shall serve any papers in opposition to the Commission's Request for a Preliminary Injunction so as to be received no later than three days prior to the time established in Section I of this Order for a hearing on the Commission's Application for a Preliminary Injunction. Service shall be made by delivering the papers to the Commission at 219 South Dearborn Street, Room 1204, Chicago, Illinois 60604, to the attention of Gregory von Schaumburg, Esquire, or such other place as counsel for the Commission may direct in writing by the most expeditious means available.

XII.

This temporary restraining order shall be in effect to and including May 31, 1989 at 10:45 a.m., unless extended by order of Court.

/s/ Marvin E. Aspen
United States District Judge

Dated: Chicago, Illinois
May 21, 1989
10:45 a.m.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case Number: 89 C 4204 Date: SEP 8, 1989

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: SECURITIES AND EXCHANGE COMMISSION v. CHERIF, et al.

* * * * *

DOCKET ENTRY:

(1) ☐ Judgment is entered as follows:

(2) ☒ [Other docket entry:]

The Motion of Plaintiff for Preliminary Injunction is granted.

/s/ Charles R. Norgle

* * * * *

(12) ☒ (For further detail see

☒ order on the reverse of

☐ order attached to the original minute order form.)

* * * * *

(Reverse Side)

ORDER

Counsel for all parties are advised that the court has decided, based upon all submissions of counsel, that no evidentiary hearing is required on the issues relating to the Preliminary Injunction or Motion to Dismiss Preliminary Injunction.

There is no serious factual controversy.

Further, the court has granted the Plaintiff's Motions for Preclusion and Adverse Inferences.

Preliminary Injunction may be granted without an evidentiary hearing, where there is no serious factual controversy. *Spartacus Youth League v. Board of Trustee of the Illinois Industrial University*, 502 F. Supp. 789, 805 (N.D. Ill. 1980). The Seventh Circuit has affirmed grant of preliminary injunction without an evidentiary hearing where the party enjoined failed, as Cherif has done, to rebut testimony adduced by the movant with witnesses or responsive affidavits. *People of the State of Illinois ex rel. Hartigan v. Peters*, 871 F.2d 1336 (7th Cir. 1989).

In order to grant a preliminary injunction, a court must find: 1) the plaintiff has at least a reasonable likelihood of success on the merits; 2) the plaintiff has no adequate remedy at law and will be irreparably harmed if the injunction does not issue; 3) the threatened injury to the plaintiff outweighs the threatened harm the injunction may inflict on the defendant; and 4) the granting of a preliminary injunction will not disserve the public interest. *Adams v. Attorney Registration and Disciplinary Comm'n*, 801 F.2d 968, 971 (7th Cir. 1986), *citing Fox Valley Harvestore, Inc. v. A. O. Smith Harvestore Products, Inc.*, 545 F.2d 1096, 1097 (7th Cir. 1976); *see also Roland Machinery Co. v. Dressler Industries*, 749 F.2d 380, 386-89 (7th Cir. 1984). The plaintiff has the burden of proving each of these factors. *Roland v. Air Line Employees Ass'n*, 753 F.2d 1385, 1392 (7th Cir. 1985).

The ultimate decision in weighing and balancing these factors requires a high degree of discretion on the part of the trial judge. *Adams*, 801 F.2d at 971; *A.J. Canfield Co. v. Vess Beverages, Inc.*, 796 F.2d 903, 906 (7th Cir. 1986); *Lawson Products, Inc. v. Avnet, Inc.*, 782 F.2d 1429, 1437 (7th Cir. 1986). Thus, the trial court's determination as to whether to issue an injunction is given substantial deference on review. *Adams* 801 F.2d at 971; *A.J. Canfield*, 796 F.2d at 906; *Lawson Products*, 782 F.2d at 1437; *Roland Machinery*, 749 F.2d at 390.

The virtually agreed facts in this case support the granting of the Motion for Preliminary Injunction.

The uncontested Verified Complaint, twenty uncontroverted declarations, plus documentary evidence including First National Bank of Chicago's ("First Chicago" or "the Bank") computer log of the night and weekend entries using Cherif's magnetic identity card, trading records in the Cherif and Sanchou accounts, and the transcript of Cherif's admissions in the FBI wire transcript adduced by the Commission constitute an overwhelming *prima facie* showing of Cherif's violation. In addition, the Commission had filed with the court a certified copy of the Pleas Agreement of Cherif's confederate William Bronec, Jr., which sets forth the basic facts of the insider trading scheme and Cherif's central role in the scheme.

The Motion of plaintiff for Preliminary Injunction is granted.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case Number: 89 C 4204 Date: SEP 27, 1989

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: SECURITIES AND EXCHANGE COMMISSION v. CHERIF, et al.

* * * * *

DOCKET ENTRY:

(1) ☐ Judgment is entered as follows:

(2) ☒ [Other docket entry:]

Defendant Khaled Sanchou's motion to vacate or, in the alternative modify preliminary injunction is denied for the reasons stated by the court in its order of September 27, 1989 denying Cherif's motion to amend temporary restraining order and by the SEC in its opposition to the motion.

/s/ Charles R. Norgle

* * * * *

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case Number: 89 C 4204 Date: SEP 27, 1989

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: SECURITIES AND EXCHANGE COMMISSION v. CHERIF, et al.

* * * * *

DOCKET ENTRY:

(1) ☐ Judgment is entered as follows:

(2) ☒ [Other docket entry:]

Defendant Danny O. Cherif's motion to amend temporary restraining order is denied.

/s/ Charles R. Norgle

* * * * *

(12) ☒ (For further detail see

☒ order on the reverse of

☐ order attached to the original minute order form.)

* * * * *

(Reverse Side)

ORDER

Cherif's motion seeks amendment of that portion of the temporary restraining order which froze his assets so that he can use a portion of the frozen assets to fund his defense in this civil action and in a pending criminal action. During the pendency of this motion, the TRO was replaced by a preliminary injunction. *See* Order dated September 8, 1989. Cherif has failed to demonstrate that he has a legitimate claim to any of the frozen assets—that any portion of the assets are free from the taint of the securities fraud alleged by the SEC. *See Federal Saving & Loan Insurance Corp. v. Dixon*, 835 F.2d 554, 565 (5th Cir. 1987). One method by which Cherif could have accomplished this would have been to provide an accounting as he was ordered on May 21, 1989. Choosing instead to disobey the court's order, Cherif has failed to do so. His motion is denied. *See United States v. Monsanto*, 109 S.Ct. 2657 (1989); *Caplin & Drysdale, Chartered v. United States*, 109 S.Ct. 2646 (1989).

/s/ Charles R. Norgle

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case Number: 89 C 4204 Date: FEB 12, 1990
Name of Assigned Judge: CHARLES R. NORGLE
Case Title: SEC v. CHERIF and SANCHOU

* * * * *

DOCKET ENTRY:

(1) ☐ Judgment is entered as follows:

(2) ☒ [Other docket entry:]

The motions to reconsider are denied.

/s/ Charles R. Norgle

* * * * *

(12) ☒ (For further detail see
☒ order on the reverse of
☐ order attached to the original minute order form.)

* * * * *

(Reverse Side)

ORDER

Before the court are three motions to reconsider, brought pursuant to Fed. R. Civ. P. 59(e). Defendant, Danny O. Cherif moves that the court reconsider both its Order of September 8, 1989, granting plaintiff's Motion for Preliminary Injunction and denying Cherif's Motion to Dismiss and its Order of September 27, 1989 denying Cherif's Motion to Amend Temporary Restraining Order. Defendant, Khaled Sanchou moves that the court reconsider its Order of September 27, 1989, which denied Sanchou's Motion to Vacate or, in the Alternative, Modify Preliminary Injunction.

Motions to reconsider are ordinarily granted only to correct clear errors of law or fact or to present newly discovered evidence which could not have been adduced during the pendency of the motion. *Publishers Resource v. Walker-Davis Publications*, 762 F.2d 557, 561 (7th Cir. 1985). Motions for reconsideration cannot be used to introduce new legal theories for the first time, or to raise legal argumentation which could have been heard during the pendency of the previous motion. *Publishers Resource*, 762 F.2d at 561; *In re Sisson*, 668 F. Supp. 1196, 1197 (N.D. Ill. 1987).

These motions raise no new issues of fact or law, but rather raise the same unsuccessful arguments which were previously raised, subjected to extensive briefing and soundly rejected by the court.

The motions to reconsider are denied.